

# ARTICLES

## State Regulation of Franchising: The Washington Experience Revisited

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### I. INTRODUCTION

Thirty-six years ago, and one year after Washington became the second state in the nation to enact a statute regulating franchise relationships, Professor Donald S. Chisum wrote the seminal article on franchising in Washington, *State Regulation of Franchising: The Washington Experience*.<sup>1</sup> Professor Chisum's article has been one of the few reference sources for Washington franchise law, and it has been the primary source relied on by courts addressing claims under Washington's Franchise Investment Protection Act (FIPA).<sup>2</sup>

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1. Donald S. Chisum, *State Regulation of Franchising: The Washington Experience*, 48 WASH. L. REV. 291 (1973).

2. Most every court that has addressed a franchising question in Washington has relied on Professor Chisum's analysis. See *Blanton v. Mobil Oil*, 721 F.2d 1207, 1220 (9th Cir. 1983) (discussing Professor Chisum's "exhaustive analysis" of FIPA); see also *Nelson v. Nat'l Fund Raising Consultants, Inc.*, 120 Wash. 2d 382, 842 P.2d 473 (1992); *Morris v. Int'l Yogurt Co.*, 107 Wash. 2d 314, 729 P.2d 33 (1986); *Allison v. Medicab Int'l, Inc.*, 92 Wash. 2d 199, 597 P.2d 380 (1979); *E. Wind Express, Inc. v. Airborne Freight Corp.*, 95 Wash. App. 98, 974 P.2d 369 (1999); *Dale v. Black*, 81 Wash. App. 599, 915 P.2d 1116 (1996); *Brader v. Minute Muffler Installation, Ltd.*, 81 Wash. App. 532, 914 P.2d 1220 (1996), *amended by* 922 P.2d 825 (1996); *Corp v. Atlantic-Richfield Co.*, 67 Wash. App. 520, 837 P.2d 1030 (1992), *rev'd on other grounds*, 122 Wash. 2d

Yet, Professor Chisum's article is outdated. Since Professor Chisum originally published his article, the Federal Trade Commission (FTC) has promulgated and amended regulations governing the sale of franchises nationally,<sup>3</sup> and two different groups have drafted uniform franchise acts.<sup>4</sup> In Washington, the legislature significantly amended FIPA in 1991,<sup>5</sup> and courts have addressed some of the unresolved issues under the statute.<sup>6</sup> As a result of these changes, and the thundering silence that has persisted on a wide variety of FIPA issues,<sup>7</sup> the lack of discourse on the state of franchising in Washington since Chisum's article has bred a considerable degree of uncertainty.

This Article assesses the changed state of franchise law in Washington. Part II considers the economic impact of franchising and the need for a review of franchising in Washington. Part III reviews the historical foundation for Washington's current franchise laws, the context in which they were created, and the changes to franchise law that drive our modern understanding of FIPA today. Part IV addresses the current regulatory scheme in Washington, including practical considerations such as franchise registration, disclosure, and state enforcement powers. Finally, Part V addresses civil liability for violations of FIPA's registration, disclosure, and relationship provisions.

## II. THE ECONOMIC IMPACT OF FRANCHISING

As a business model, franchising was nearly unheard of before the 1950s.<sup>8</sup> Today, there are more than 900,000 establishments in franchise systems in the United States, creating over 11 million jobs and producing nearly \$900 billion in annual output.<sup>9</sup> Franchised businesses directly account for 8.1% of all private sector jobs in the U.S., with annual payrolls of approximately \$280 billion.<sup>10</sup> In 2005, franchised businesses

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574, 860 P.2d 1015 (1993); *Rutter v. BX of Tri-Cities, Inc.*, 60 Wash. App. 743, 806 P.2d 1266 (1991); *Lobdell v. Sugar 'N Spice, Inc.*, 33 Wash. App. 881, 658 P.2d 1267 (1983).

3. *See* Disclosure Requirements and Prohibitions Concerning Franchising, 16 C.F.R. § 436 (2008).

4. UNIF. FRANCHISE & BUS. OPPORTUNITIES ACT (1987); MODEL FRANCHISE INV. ACT (1990).

5. An Act Relating to Franchise Investment Protection, ch. 226, 1991 Wash. Sess. Laws 1123.

6. *See* discussion *infra* Part V.

7. Although several key issues have been addressed by Washington courts since FIPA was enacted, many questions remain officially unresolved as a result of the courts' penchant for issuing unpublished decisions. Under Washington law, such opinions are neither controlling nor persuasive authority and may not be cited as precedent in support of a proposition. *See* Wash. R. App. P. 10.4(h).

8. *See* discussion *infra* Part III.A.

9. PRICEWATERHOUSECOOPERS, THE ECONOMIC IMPACT OF FRANCHISED BUSINESSES, VOLUME II: RESULTS FOR 2005, at 6 (2008), available at <http://www.buildingopportunity.com/download/Part1.pdf>.

10. *Id.*

employed 2 million more workers in the U.S. than manufacturers of durable goods,<sup>11</sup> which have long been considered a benchmark of U.S. economic stability.<sup>12</sup>

Moreover, franchised businesses create jobs and output far beyond their direct contributions to the economy. Studies combining direct and indirect contributions of franchised businesses estimate that franchisees result in more than 21 million jobs nationwide, approximately 15.3% of all private-sector jobs.<sup>13</sup> In addition, the studies estimate that franchised businesses support a payroll of over \$660 billion and contribute more than \$2.3 trillion in annual output, amounting to 11.4% of the entire U.S. economic output in the private sector.<sup>14</sup> In total, this amounts to more than one-third of all domestic retail sales.<sup>15</sup>

In addition, unlike traditional corporate models, where success and profits inure only to the benefit of upper echelon management and shareholders, the net benefits of franchising can be measured throughout the entire franchise system.<sup>16</sup> Profitable franchising systems benefit the franchisee by providing an established brand and system of operation, thereby decreasing the likelihood that the business will fail.<sup>17</sup> This creates a wealth of opportunities for innovative and entrepreneurial franchisees to start and own their own business.<sup>18</sup> This system of vertical integration also affords small business owners an easy and effective method for growing businesses when capital is not easily accessible.<sup>19</sup> Instead of

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11. *Id.* Specifically, in 2005, franchised businesses employed an estimated 11,029,000 workers. This estimate represents a significant portion of the U.S. economy as compared with other economic sectors that are more often identified in traditional economic analyses, such as durable goods manufacturers (8,955,000 workers), financial activities (8,153,000 workers), construction (7,366,000 workers), nondurable goods manufacturing (5,272,000 workers), and information services (3,061,000 workers). *Id.*

12. Since at least 1958, the United States Census Bureau has maintained a monthly index measuring the number of orders placed with U.S. manufacturers for durable goods. See U.S. CENSUS BUREAU, DESCRIPTION OF THE MANUFACTURERS' SHIPMENTS, INVENTORIES, AND ORDERS (M3) SURVEY, at v–vii (2007), available at <http://www.census.gov/indicator/www/m3/m3desc.pdf>. The index provides an indication of the strength of U.S. manufacturers and is often used to forecast rising and falling employment numbers in the manufacturing sector.

13. See PRICEWATERHOUSECOOPERS, *supra* note 9, at 7.

14. *Id.*

15. David Gurnick & Steve Vieux, *Case History of the American Business Franchise*, 24 OKLA. CITY U. L. REV. 37, 47 (1999).

16. URBAN B. OZANNE & SHELBY D. HUNT, THE ECONOMIC EFFECTS OF FRANCHISING 63 (1971).

17. *Id.*

18. *Id.*

19. *Id.* (“[F]ranchising has enabled many entrepreneurs with little capital to take an idea and from it build a large multi-unit organization. Without franchising, these entrepreneurs would have had to give up their idea or attempt to sell it to some large corporation.”); see also Darrell Johnson, *Franchising Expansion Fueled by Industry Entrepreneurs*, FRANCHISING WORLD, Dec. 2007, at 42–

using a traditional corporate model, which would require substantial capital investments, small business owners can turn to franchising and rely on franchisees to put forward investment capital and labor.<sup>20</sup>

In 1971, recognizing the important role that franchising would play in the economic future of the state, the Washington legislature enacted FIPA.<sup>21</sup> The legislature modeled the statute after state and federal securities laws, imposing regulations upon the advertising and sale of franchises.<sup>22</sup> The legislature intended that FIPA be broad in scope, so that it could regulate many aspects of the post-sale relationship between franchisors and franchisees.<sup>23</sup> The legislature's enactment of FIPA accurately foreshadowed the emergence of franchising as a force in the state's economy. Although distribution of the economic benefits of franchising is not perfectly uniform across the U.S.,<sup>24</sup> the impact of franchising is not segregated geographically,<sup>25</sup> and Washington has been a full participant in the trend toward franchising. As of 2005, franchised businesses created or contributed to 14% of all jobs in the state, 11.2% of employer payroll, and 10.4% of output.<sup>26</sup> Franchising today represents a crucial element of Washington's economic infrastructure.

43 (stating that the growth in franchised businesses in recent years is in large part attributable to the success of new franchise concepts).

20. OZANNE & HUNT, *supra* note 16, at 63.

21. Franchise Investment Protection Act, ch. 252, 1971 Wash. Sess. Laws, 1st Ex. Sess. 1128, amended by ch. 116, 1972 Wash. Sess. Laws, 1st Ex. Sess. 259.

22. James Fletcher, *Franchise Investment Protection Act* 14–15 (1971) (unpublished thesis, on file with University of Washington Gallagher Law Library). As with state laws applying to advertising and sales of securities, FIPA requires registration and disclosure of franchise offerings prior to sale. See WASH. REV. CODE §§ 19.100.040–.080 (2008). Similarly, FIPA's antifraud provisions are copied nearly verbatim from Securities and Exchange Commission Rule 10(b)(5). Compare 17 C.F.R. § 240.10b-5 (2008), with WASH. REV. CODE § 19.100.170 (2008).

23. Fletcher, *supra* note 22, at 14–15.

24. Relative to the size of a state's economy, franchising has the greatest economic impact on jobs in Nevada, New Mexico, Arizona, Mississippi, and South Dakota. However, given the relatively small population size of these states, it is unsurprising that states with large populations such as California, Texas and Florida boast the greatest franchise employment figures. See PRICEWATERHOUSECOOPERS, *supra* note 9, at 10.

25. For example, jobs created by franchised businesses comprise at least 10% of the private-sector workforce in every state except New York (9.5%). *Id.*

26. *Id.* at 22–26. The relatively low output percentage is perhaps attributable to Washington's income generated from exports. Despite the relatively small population size of the state, Washington has consistently ranked in the top five states in exports during the last decade and, in 2007, ranked fourth in total exports behind only Texas, California, and New York. See WASHINGTON STATE OFFICE OF FINANCIAL MANAGEMENT, WASHINGTON TRENDS (2008), available at <http://www.ofm.wa.gov/trends/tables/fig106.asp> [hereinafter WASHINGTON TRENDS] (citing World Institute for Strategic Economic Research Foreign Trade Database, available at <http://www.wisertrade.org/home/index.jsp>). About 64% of Washington's exports are attributable to aircraft and aircraft parts manufactured primarily by the Boeing Corporation. See WASHINGTON TRENDS *supra*.

Despite the importance of franchising to Washington's economy, there has been relatively little written about FIPA and the role it plays in regulating franchised businesses since Professor Chisum first put his mark on the topic in 1973. The lack of discourse underscores the critical need for a reexamination of franchise laws in Washington, particularly in light of the nearly four decades of evolution that franchising has undergone at both the state and federal levels. The following Part describes the most significant changes in franchise law at the state and national levels over this period.

### III. HISTORY OF WASHINGTON FRANCHISING LAW

#### A. *The World of 1970: Franchise Regulation Begins*

Franchise businesses in the private sector have existed since the early 1800s with varying degrees of success.<sup>27</sup> For nearly a century, a variety of businesses engaged in crude product-distribution franchise arrangements created through exclusive distributorships and dealerships.<sup>28</sup> But it was not until the 1950s that franchising truly exploded onto the scene for the average American with the invention of the business format franchise concept.<sup>29</sup> Early pioneers of the business format franchise included McDonald's and Domino's Pizza, companies that licensed out their business methods and trademarks to independent small business owners who operated the businesses under strict company guidelines.<sup>30</sup> The success of the business format franchise in the 1950s was quickly apparent, as more than 90% of the franchise companies in existence in 1970 began their operations after 1954.<sup>31</sup>

The overwhelming success of the new system led to the typical excesses that occur in any economic bubble: abuses are lost in the euphoria of a growing economy and booming markets.<sup>32</sup> Similar to the economic bubbles that have plagued the U.S. economy over the last

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27. See Gurnick & Vieux, *supra* note 15, at 42–47 (citing THOMAS S. DICKE, *FRANCHISING IN AMERICA* (1992)).

28. Gurnick & Vieux, *supra* note 15, at 42–47.

29. *Id.* at 47. Unlike product distribution and dealership franchises, business format franchising is the form of franchising with which most Americans are familiar. *Id.* at 48. Under this model, the franchisee follows guidelines from the franchisor on product development and marketing and sells products from the sole manufacturer. *Id.* In essence, the franchise is the product, often accompanied by a recognizable brand name that entices customers to purchase goods and services. *Id.* See also Chisum, *supra* note 1, at 294–95.

30. Gurnick & Vieux, *supra* note 15, at 48.

31. Statement of Basis and Purpose, 43 Fed. Reg. 59,614, 59,623 (Dec. 21, 1978).

32. Cf. J. Robert Brown, Jr., *The Irrelevance of State Corporate Law in the Governance of Public Companies*, 38 U. RICH. L. REV. 317, 357 (2004).

decade,<sup>33</sup> the franchise boom in the 1960s saw some franchisors abuse their positions of authority to secure enormous profits at the expense of their franchisees.<sup>34</sup> These abusive practices ranged from false or misleading promises to outright fraud.<sup>35</sup> Franchisee complaints spawned by this abusive behavior led to massive investigations and reforms in the early 1970s at both the state and federal levels.<sup>36</sup>

Although franchisee advocates complained loudly of these abusive practices, there was little or no empirical evidence to support their claims of widespread abuses by franchisors.<sup>37</sup> Nonetheless, reform advocates gained traction by heavily publicizing the most egregious examples of franchisor misconduct.<sup>38</sup> One prominent franchisee advocate was the attorney general of New York, who concluded that many franchisors were “fly-by-night” operations with little or no substance that made misrepresentations and fraudulent claims in order to convince naïve citizens to surrender their life savings to purchase worthless franchises.<sup>39</sup>

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33. *Id.*

34. An infamous example was the Minnie Pearl’s Chicken System, a restaurant franchise concept owned by Performance Systems, Inc. (PSI). In 1968, the franchisor sold hundreds of franchises when only five restaurants were actually open. Within two years, only a fraction of the franchises sold were in operation, PSI’s stock price had plummeted and, after lengthy investigations by the FTC and SEC, PSI went out of business. Julie Bennett, *What Really Happened to Minnie Pearl Fried Chicken?*, FRANCHISE TIMES, June-July 2007, at 12; see also Norman D. Axelrad, *Franchising: Changing Legal Skirmish Lines or Armageddon? Some Observations from the Foxhole*, 26 BUS. LAW. 695, 704 (1971) (“In the late 1960’s over-optimistic and clearly distorted appraisals of franchising were spread by a business and consumer press enthusiastically extolling its limitless growth prospects and glowing, get-rich stories.”).

35. Gurnick & Vieux, *supra* note 15, at 53. A common source of franchisee complaints arose out of the termination or non-renewal of franchise agreements. As franchisees devoted significant investments to the development of their franchises, they often believed that the franchisor’s unwarranted refusal to renew the franchise relationship wrongfully caused injury and loss of that investment. *Id.* at 54.

36. *Id.* at 53–54 (“In 1969, the Securities and Exchange Commission and the Attorneys General of California and New York initiated actions against franchise promoters. By 1970 numerous highly publicized suits had also been initiated by franchisees against franchisors.”).

37. See, e.g., William L. Killion, *The Modern Myth of the Vulnerable Franchisee: The Case for a More Balanced View of the Franchisor-Franchisee Relationship*, 28 FRANCHISE L.J. 23, 26–27 (2008).

38. *Id.*

39. *Id.* at 26 (quoting Memorandum from David Clurman to Attorney General Lefkowitz (Jan. 7, 1970) (reproduced in *Hearings Before the S. Subcomm. on Urban and Rural Economic Development of the Select Comm. on Small Business*, 91st Cong. 526–38 (1970)). Similarly, in public hearings before the Federal Trade Commission, witnesses testified at length about the worst examples of franchisor unfair trade practices identifying franchisors’ (1) false or unsubstantiated claims of profitability, (2) failure to abide by promises to refund the purchase price if the franchise turned out to be unprofitable, and (3) failure to disclose material facts pertinent to the sale of the franchise. See Statement of Basis and Purpose, 43 Fed. Reg. 59,614, 59,628 (Dec. 21, 1978). Although there were a number of egregious examples of franchisee conduct presented at the congressional hearings in 1970, the record contains no data supporting the conclusion that franchisor abuse was widespread in the industry. See Killion, *supra* note 37, at 27 (“[T]he empirical data did not support the rhetoric

Other commentators advocated strenuously for tighter controls over franchising in general, arguing that the imbalance in bargaining power between the large franchisor and its franchisees made abusive practices inevitable.<sup>40</sup> The resulting conventional wisdom was that franchisees were incapable of protecting their own interests in the face of the franchisor's institutional advantages.<sup>41</sup>

It was in this context that the Washington legislature took up the task of enacting franchise legislation in 1971. Locally, the drive for reform was initiated by the Attorney General's Office as a result of outrage over an incident in 1968 in which a foreign corporation fraudulently induced Washington residents to purchase vending machine franchises.<sup>42</sup> The company never delivered the vending machines to any franchisees, and the franchisor's corporate principals were subsequently indicted for their fraudulent behavior.<sup>43</sup> Viewed in conjunction with the national investigation into franchise practices, reformers in Washington concluded that franchisees as a group were inexperienced individuals who, lacking access to expert advice, were investing a substantial portion of their savings to obtain franchised businesses without the benefit of full disclosure of material facts.<sup>44</sup> Reformers also argued that franchisors'

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coming from franchising's most vocal critics.") (citing *The Impact of Franchising on Small Business: Hearing Before the S. Subcomm. on Urban and Rural Economic Development of the Select Comm. on Small Business*, 91st Cong. 311 (Jan. 27, 1970) (statement of John V. Buffington, General Counsel of the Federal Trade Commission) ("[F]rankly, the Commission does not know the extent of the use of exploitative practices in franchising. We receive relatively few complaints on such matters.")).

40. HAROLD BROWN ET AL., *THE REALITIES OF FRANCHISING* (1970); Harold Brown, *Franchising—A Fiduciary Relationship*, 49 TEX. L. REV. 650, 664 (1971); Chisum, *supra* note 1, at 297 ("The franchisor normally occupies an overwhelmingly stronger bargaining position and drafts the franchise agreement so as to maximize his power to control the franchisee.").

41. Statement of Basis and Purpose, 43 Fed. Reg. 59,614, 59,627 (Dec. 21, 1978) (stating that the power imbalance between franchisors and franchisees "creates a situation where the opportunity for deception is ripe and the need for protection clear").

42. Fletcher, *supra* note 22, at 2–3. Ironically, this sort of scheme does not fall within today's definition of what constitutes a franchise. Instead, this type of agreement would fall within Washington's Business Opportunity Fraud Act, which regulates contracts that primarily involve the sale or lease of equipment to enable the purchaser to start a business. See generally WASH. REV. CODE § 19.110 (2008). Unlike in franchise agreements, there is no licensing of trademark rights associated with the sale of a business opportunity. Today, most states, including Washington, treat sales of business opportunities with greater scrutiny than traditional franchise arrangements because they are much more likely to be fraudulent. But the confusion at that time was unsurprising given that there was no clear national understanding of what constituted a franchise, or how a franchise differs from a business opportunity.

43. Fletcher, *supra* note 22, at 3.

44. *Id.* at 7–11 ("The result of our investigation, coupled with the conclusions reached by the Federal Trade Commission, the New York State Attorney General's Office, and other states which have investigated franchising, clearly demonstrated the need for franchise legislation."); see also Chisum, *supra* note 1, at 297.

non-disclosures were exacerbated by the power imbalance between the parties that made it possible for franchisors to exact unreasonable conditions from franchisees after the parties executed the agreement.<sup>45</sup>

The federal government's initial response to the franchise regulatory crisis did not satisfy the urgent call for reform echoing through state legislative chambers at the beginning of the 1970s. Unsurprisingly, California started the trend toward greater franchise regulation in 1970, when the state legislature enacted the California Franchise Investment Law.<sup>46</sup> California loosely based its law on its securities act and required franchisors to register franchise offerings with the state, as well as to provide prospective franchisees with disclosures of specifically identified information that the state deemed material to the sale of the franchise.<sup>47</sup> California's statute also regulated certain aspects of the post-sale relationship.<sup>48</sup> These so-called relationship statutes imposed specific limitations on franchisors in their conduct toward franchisees.<sup>49</sup> A number of states quickly followed suit, and by the end of the decade, a total of thirteen states had enacted franchise regulatory statutes.<sup>50</sup> All but one

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45. Fletcher, *supra* note 22, at 12–13 (“[FIPA] merely seeks to equalize the powers of the respective parties and to insure that good faith is practiced in all transactions between the parties.”); *see also* Chisum, *supra* note 1, at 297–98 (“Franchisors have used [their unequal bargaining] power to terminate franchises arbitrarily, to coerce franchisees under threat of termination, and to force franchisees to purchase supplies from the franchisor or approved suppliers at unreasonable prices, to carry excessive inventories, to operate long, unprofitable hours, and to employ other unprofitable practices.”).

46. *See* CAL. CORP. CODE §§ 31000–31516 (West 2008).

47. *Id.* *See also* Gurnick & Vieux, *supra* note 15, at 58; Peter C. Lagarias, *The Misuse of Integration, No Representation, and No Reliance Clauses in the Name of Contract Certainty*, 18 FRANCHISE L.J. 3, 3 n.6 (1998) (“[T]he California Franchise Investment Law . . . was modeled on the California blue sky securities statutes.”).

48. *See* California Franchise Relations Act, CAL. BUS. & PROF. CODE §§ 20000–20040.5 (2008).

49. For example, franchisors are prohibited both from restricting or inhibiting the right of franchisees to join trade associations and from restricting the right of free association among franchisees. *See* CAL. CORP. CODE § 31220 (West 2008). *See also* California Franchise Relations Act, CAL. BUS. & PROF. CODE §§ 20000–20040.5 (West 2008). FIPA is based upon a broader bill proposed (but never enacted) in Massachusetts which regulated many more areas of franchisor-franchisee relations. *See* Chisum, *supra* note 1, at 335 (citing Fair Dealing in Franchising Act, H. 2279 (Mass. 1970), reproduced in *Report of the Senate Select Comm. on Small Business on the Impact of Franchising on Small Business, Based on Hearing Before the Subcomm. on Urban and Rural Economic Development*, 91st Cong., 2d. Sess., at 1 (1970)).

50. California, Hawaii, Illinois, Indiana, Maryland, Michigan, Minnesota, North Dakota, Rhode Island, South Dakota, Virginia, Washington and Wisconsin. At one point, these states had within their collective jurisdictions in excess of 36% of all business format franchises in the United States. *See* Timothy H. Fine & Myron P. Gordon, *The Proposed Uniform Franchise Act: The Franchisee Viewpoint*, 5 FRANCHISE L.J. 10, 10 (1986). Recent studies suggest that that percentage has declined slightly, to approximately 33%. *See* PRICEWATERHOUSECOOPERS, *supra* note 9.

of those states followed California's lead, requiring pre-sale registration and approval by the state, as well as disclosure of franchise offerings.<sup>51</sup>

Washington's FIPA was enacted during an era of rampant speculation over the scope of fraudulent practices in the franchise industry. Many of FIPA's more draconian regulatory measures are a product of that environment. But the need for strict franchise regulation has eased over the last thirty-five years as the power and information imbalance between franchisors and franchisees has shifted or disappeared entirely. In particular, in the decade after FIPA's enactment, national efforts to standardize the regulation of franchising significantly altered the environment for state regulation of franchising. It is in this context, not through the lens of the 1970s, that Washington franchise law is best understood today.

*B. Franchise Regulation's Second Act:  
National Regulation by the Federal Government and  
Efforts to Create a Uniform State Regulatory Model*

After the initial wave of franchise regulatory changes swept its way through the states, consensus began to build for the adoption of a national strategy on franchise regulation. These efforts to create a more comprehensive approach to franchise regulation culminated in the adoption of regulations by the FTC and the promulgation of two uniform franchise acts.

1. The FTC Enacts Regulations Governing the  
Advertising and Sale of Franchises

One of the primary contributors to the change in franchise law has been the FTC, through its adoption of regulations governing the sale of franchises.<sup>52</sup> Following hearings and investigations of franchise practices, the FTC initiated rulemaking proceedings in 1971 to formulate regulations on the sale and advertising of franchises.<sup>53</sup> The rulemaking proceedings lasted until 1978, when the FTC promulgated a final trade regulation rule that became effective on October 21, 1979.<sup>54</sup> The promulgation of the FTC rule effectively silenced further efforts to institute

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51. Oregon requires only disclosure of information to prospective franchisees. *See* OR. REV. STAT. § 650.020 (2008); OR. ADMIN. R. 441-325-0020 (2008). Franchisors are not required to register offerings with the state, and there are no post-sale relationship provisions.

52. *See* 16 C.F.R. §§ 436.1-7 (2008).

53. *See* Statement of Basis and Purpose, 43 Fed. Reg. 59,614, 59,623 (Dec. 21, 1978).

54. *See id.* at 59,614.

franchise reform at the state level because the remaining states without franchise laws saw no further need to regulate the sale of franchises.<sup>55</sup>

Unlike a number of state laws enacted in the early 1970s, the FTC rule did not require franchisors to register their franchise offerings, and it did not regulate the post-sale franchise relationship.<sup>56</sup> Instead, the rule required franchisors to disclose certain material information to franchisees only in connection with the sale of a franchise.<sup>57</sup> The rule was intended to correct the “serious informational imbalance” found to exist between franchisors and franchisees.<sup>58</sup> Over time, this information has enabled franchisees to conduct meaningful due diligence investigations of potential franchise opportunities and to comparison shop for the best franchise offerings.<sup>59</sup> It has also helped franchisees better understand the franchise relationship they are pursuing, reducing potential post-sale conflicts between the parties.<sup>60</sup> The rule has significantly altered the balance of power between franchisees and franchisors, thereby greatly reducing the need for draconian state regulatory measures.<sup>61</sup>

## 2. The Stalled Push for Uniformity: The Uniform Franchise and Business Opportunities Act and the Model Franchise Investment Act

Despite the chilling effect of the federal franchising rule on state reform, the national trend in increasing regulation of franchising did not end in 1979. The FTC’s decade-long process in implementing the federal regulatory scheme, and the intervening state legislation enacted to fill the void, created an opening for national legislative reform advocates. Those advocates drafted uniform franchise laws in the hopes that they

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55. New York is the only exception, as it enacted franchising laws in 1980. No state since New York has seen the need to enact franchising statutes beyond what is already called for under the FTC rule. In fact, the trend at the state level since New York’s statute was enacted has been toward less regulation. For example, Michigan originally required both registration and disclosure. However, the state repealed the registration requirement in 1984 in favor of notice filing. MICH. COMP. LAWS § 445.1507a (2008); *see also* 1984 Mich. Pub. Acts 92. Unlike registration filings in other states that require extensive document submissions and review by state regulators, notice filing in Michigan is limited to submission of a document to the State Attorney General’s Office that identifies the franchisor’s name, business name and address. MICH. COMP. LAWS § 445.1507a (2008). Since Michigan’s repeal of registration requirements in 1984, two other states have followed suit and require only notice filing: Wisconsin (1996) and Indiana (2001).

56. *See* Statement of Basis and Purpose, 43 Fed. Reg. 59,614 (Dec. 21, 1978).

57. *Id.*

58. *Id.* at 59,625.

59. Statement of Basis and Purposes, 72 Fed. Reg. 15,444, 15,447 (Mar. 30, 2007).

60. *Id.*

61. *See id.* at 15,447 n.32 (quoting a commenter who stated that the FTC rule and state franchise laws have “gone a long way toward eradicating massive franchise frauds and, by doing so, have restored franchising’s reputation for integrity and thus cleared the marketplace for the offerings of legitimate franchisors”); *see also* Keith J. Kanouse & H. Stephen Brown, *AAFD’s “Fair Franchising Standards”*: *The Case For*, 16 FRANCHISE L.J. 59, 61 (1996).

may someday replace the unfortunate patchwork of state and federal law that imposed significant regulatory hurdles on any franchisor with national ambitions.

*i. The Uniform Franchise and Business Opportunities Act*

Sensing a need for national uniformity in franchise law, the National Conference of Commissioners on Uniform State Laws (NCCUSL) was the first to take up the cause of uniform franchise laws in 1983.<sup>62</sup> Although NCCUSL's original mandate was to create uniform laws for the regulation of business opportunities,<sup>63</sup> the initial drafting committee broadly expanded the effort to include franchise relationships.<sup>64</sup> After a

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62. Jack Davies, *Why the Proposed Uniform Franchise Act?*, 5 FRANCHISE L.J. 5, 5 (1986).

63. In general, "business opportunities" are similar to franchises in that they both involve the sale of products or services to enable a person to start a business. See Keith J. Kanouse, *An Overview of Federal and State Business Opportunity Laws*, 23 FRANCHISE L.J. 102, 102 (2003). But business opportunities differ from franchises in that there is no license of a trademark in connection with the sale of a business opportunity. *Id.* State laws tend to define business opportunities broadly, although the definitions tend to fall within one of five different categories: (1) offers by the seller to provide vending machines and rack displays; (2) offers by the seller to repurchase products grown, manufactured, or assembled by the buyer; (3) offers by the seller guaranteeing the buyer's investment; (4) sales or marketing programs; and (5) representations by the seller that there is a market for particular goods or services. *Id.* After the 2007 amendments to the franchise rule, the FTC now regulates business opportunities under a different (but similar) regulatory scheme. See 16 C.F.R. § 437 (2008). Under Washington law, "business opportunities" are defined as the sale or lease of any product, equipment, supply, or service that is sold or leased to enable the purchaser to start a business, and in which the seller (1) offers services in connection with locating vending machines or similar devices; (2) represents that it will purchase any products made by the purchaser using the seller's system; (3) guarantees that the purchaser will earn an income greater than or equal to the price paid for the business opportunity; or (4) represents that if the purchaser pays a fee exceeding three hundred dollars for the seller's marketing program, the seller's program will enable the purchaser to derive income from the business opportunity that exceeds the price paid for the business opportunity. WASH. REV. CODE § 19.110.020(1) (2008). Unlike a franchise, which must be substantially associated with a trademark, a business opportunity can include any type of sales program or multi-level marketing system. See *id.* For this reason, business opportunities have traditionally been much more likely to be fraudulent programs, designed to generate revenue through the sale of the opportunity, rather than from royalties generated by the operation of the business after the sale. See Sergio Pareja, *Sales Gone Wild: Will the FTC's Business Opportunity Rule Put an End to Pyramid Marketing Schemes?*, 39 MCGEORGE L. REV. 83, 86-87 (2008). The most famous deceptive business opportunity is the Ponzi scheme, otherwise known as a pyramid scheme, whereby the business promoter generates revenue to pay members of the scheme by signing up new recruits. *Id.* at 86. The system is mathematically unsustainable because companies cannot attract new investors in perpetuity to pay the growing group of existing investors, and eventually the scheme collapses under its own weight. *Id.* at 86-87.

64. Byron E. Fox, *The Proposed Uniform Franchise Act: Its History*, 5 FRANCHISE L.J. 3, 3 (1986). A number of commentators have criticized NCCUSL's decision to group franchises with business opportunities, which is an argument that reinforces the committee's fundamental misunderstanding about the difference between franchises and business opportunities. See, e.g., Debra M. Bollinger, *The Model Franchise Investment Act Dances with Wolves*, 10 FRANCHISE L.J. 3, 3 (1991) (stating that NCCUSL "was warned that any proposed law should not cover both franchises and business opportunities . . .").

number of proposed versions were debated and revised, NCCUSL approved the final version of the Uniform Franchise and Business Opportunities Act (UFA) in 1988.<sup>65</sup> The final version of the UFA proposed a regulatory system similar to that provided by the FTC rule, relying primarily on disclosure as a means of combating fraudulent practices.<sup>66</sup> However, unlike the FTC rule,<sup>67</sup> the UFA authorized a private right of action by franchisees against franchisors for damages or other relief.<sup>68</sup>

Reaction to the UFA was almost universally negative, and it did not receive the typical level of support that accompanies most efforts to create uniform legal standards.<sup>69</sup> In particular, franchisors in states without

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65. Rupert M. Barkoff, *Walking the Uniform Franchise and Business Opportunities Act to and Through the State Legislatures*, 7 *FRANCHISE L.J.* 7 (1988); see also Davies, *supra* note 62.

66. UNIF. FRANCHISE & BUS. OPPORTUNITIES ACT § 302 (1987). The UFA eschewed formal franchise registration in favor of a much simpler notice filing with regulators. *Id.* § 305. It also eliminated specific limitations on franchisor conduct in the post-sale relationship in favor of a general good faith requirement, similar to that expressed in the Uniform Commercial Code and Restatement of Contracts. *Id.* § 201 (“A franchise . . . imposes on the parties a duty of good faith in its performance and enforcement. ‘Good Faith’ means honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade.”); see also *id.* § 201 n.1; U.C.C. § 2-103 (1977); RESTATEMENT (SECOND) OF CONTRACTS § 205 (1981).

67. The FTC’s original rule advocated for courts to allow franchisees to pursue a private right of action for violations of the franchise rule. 43 Fed. Reg. 59,614, 59,723 (Dec. 21, 1978). But the FTC rule was promulgated pursuant to the agency’s rulemaking authority delegated under the Federal Trade Commission Act, which courts have generally agreed does not authorize a private right of action. See *Morrison v. Back Yard Burgers, Inc.*, 91 F.3d 1184, 1187 (8th Cir. 1996); *R.T. Vanderbilt Co. v. Occupational Safety & Health Review Comm’n*, 708 F.2d 570, 574 n.5 (11th Cir. 1983); *Fulton v. Hecht*, 580 F.2d 1243, 1248 n.2 (5th Cir. 1978); *Alfred Dunhill Ltd. v. Interstate Cigar Co.*, 499 F.2d 232, 237 (2d Cir. 1974); *Holloway v. Bristol-Meyers Corp.*, 485 F.2d 986, 1002 (D.C. Cir. 1973); *Carlson v. Coca-Cola Co.*, 483 F.2d 279, 280 (9th Cir. 1973); *Freedman v. Melody’s, Inc.*, 587 F. Supp. 658 (E.D. Pa. 1984). But see *Guernsey v. Rich Plan of the Midwest*, 408 F. Supp. 582, 587–88 (N.D. Ind. 1976) (recognizing a private right of action for consumers under the FTCA). However, a small minority of jurisdictions have held that violations of the federal disclosure rule may be admissible as evidence in a state law cause of action. See *Florida Auto Auction of Orlando, Inc. v. United States*, 74 F.3d 498, 502 n.2 (4th Cir. 1996) (rejecting an argument that a duty imposed by federal regulations cannot give rise to a state common law claim); *TC Tech. Mgmt. Co. v. Geeks on Call Am., Inc.*, No. 2:03-CV-714-RAJ, 2004 WL 5154906, at \*5 (E.D. Va. 2004) (holding that a franchisee could use the FTC rule in establishing a fraud by omission claim against a franchisor who concealed information relating to earnings claims); *Rodopoulos v. Sam Piki Enters., Inc.*, 570 So.2d 661, 666 (Ala. 1990) (holding that federal franchise disclosure rule created a duty to disclose applicable to common law claims).

68. UNIF. FRANCHISE & BUS. OPPORTUNITIES ACT § 506 (1987) (authorizing civil claims for damages caused by the franchisor’s misrepresentations or omissions of material fact in connection with the sale of the franchise, or breach of the duty of good faith).

69. Davies, *supra* note 62, at 5. The problem was exacerbated by the nature of the topic. As most franchisors and franchisees participate on only one side of the distribution relationship, they tend to view the important issues in franchise law as a zero-sum game, where only one side will benefit from a particular policy outcome. *Id.* at 6. Consequently, there was little incentive to compromise on issues, and all the parties to the discussion ended up dissatisfied with the resulting legis-

existing franchise laws, who were newly faced with the prospect of additional regulation, complained that the NCCUSL had failed to provide any reason why additional franchise regulation was necessary.<sup>70</sup> Franchisors also complained that states with existing registration laws would be unlikely to repeal their franchise statutes in favor of the less restrictive UFA.<sup>71</sup> They argued that this layering of franchise laws would result in a net increase of regulation, without any corresponding decrease in regulation elsewhere.<sup>72</sup> Of less concern to franchisors was the UFA's post-sale relationship provision, which was modified after successful lobbying from franchisor interests to remove explicit prohibited practices in favor of a more general duty of good faith.<sup>73</sup>

Franchisees were even more dissatisfied with the UFA, primarily because they viewed it as just the opposite; namely, an attempt by franchisors to convince states with existing franchise statutes to repeal their laws in favor of the UFA, thereby diluting existing franchise protections.<sup>74</sup> To franchisee advocates, elimination of the specific relationship provisions in favor of a more general good faith requirement offered no more protection than that which they were already entitled under the Uniform Commercial Code.<sup>75</sup> They also argued that the change did not address perceived inequality in bargaining power and sophistication that had been perpetuated by franchise legislation.<sup>76</sup>

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lation. *Id.* ("As the Uniform Act is being drafted, each interest seems to be playing the advocate and staking out its bargaining position, rather than voicing approval of interim drafts.").

70. Andrew A. Caffey, *The Proposed Uniform Franchise Act: The Franchisor Viewpoint*, 5 *FRANCHISE L.J.* 7, 7 (1986) ("The Drafting Committee, however, has neatly side-stepped the entire question of whether there are compelling reasons to intervene in the marketplace, by taking the view that the question of legislative justification was answered by another committee before it received its charge to draft the bill. NCCUSL, like all legislative bodies, is in the business of legislating and does not easily turn away from the lure of generating a legislative solution—even though there may be no problem.").

71. *Id.* at 8.

72. *Id.* ("Will the Uniform Act result in uniformity? It is very doubtful. The more probable consequence is that no current registration states will change their statutes, and that the thirty-five states that do not now regulate franchising will adopt laws that vary the uniform approach to suit their political situation.").

73. *Id.* ("A good faith standard is, generally speaking, less objectionable than an extensive laundry list of prohibited practices.").

74. Fine & Gordon, *supra* note 50, at 11.

75. *Id.* ("[I]f the Uniform Act treats the franchisor/franchisee relationship as nothing more than a commercial buyer/seller situation, there is absolutely no need for the proposed act—the Uniform Commercial Code will more than suffice.").

76. *Id.* Franchisees also derided the drafting committee's switch to notice filing instead of registration as the "lowest common denominator" approach to regulation. *Id.* The primary argument in favor of a registration requirement is that it prevents undercapitalized franchisors from collecting franchise fees and then going out of business before the franchisee even begins operating the business. *Id.* at 12. Registration laws prevent this from occurring by allowing state regulators to review registration applications and to determine whether franchisors must hold franchise fees in escrow

However, the greatest opposition to the UFA was reserved to state franchise regulators and their organization, the North American Securities Administrators Association (NASAA).<sup>77</sup> Specifically, regulators opposed removal of registration requirements, citing the need to protect franchisees from potentially undercapitalized franchisors.<sup>78</sup> Administrators also agreed with franchisees that the general good faith standard offered nothing more than a restatement of the law already in existence.<sup>79</sup> But regulators were most concerned about the UFA's reliance on civil lawsuits as the only remedial enforcement mechanism.<sup>80</sup> Unsurprisingly, they advocated for giving regulators the primary role in enforcing franchise conduct standards.<sup>81</sup>

With such strenuous opposition, the UFA inevitably met with little legislative success. Although the Act was approved by the American Bar Association in 1989,<sup>82</sup> no state that previously lacked a franchise statute has adopted the Act, and none of the existing registration states adopted the regulatory approach of the UFA.

#### *ii. The Model Franchise Investment Act*

Before the ink had dried on the UFA, NASAA began drafting its own version of a uniform franchise law, a document that eventually became known as the Model Franchise Investment Act (MFIA).<sup>83</sup>

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during initial operational periods or defer initial franchise fees until the franchisee opens for business. See, e.g., WASH. REV. CODE § 19.100.050 (2008). However, the authors are unaware of any study or empirical evidence that indicates that undercapitalization is a pervasive problem such that registration is necessary and vital to protect the interests of franchisees, particularly where federal law already mandates the delivery of information to prospective franchisees about the franchisor's financial condition.

77. Founded in 1919, NASAA is a voluntary association of state, provincial, and territorial securities administrators. The organization is devoted to protecting investors, including franchisees, from fraud and abuse. See N. AM. SEC. ADM'RS ASS'N, 2008-2009 REPORT 2 (2009), available at [http://www.nasaa.org/content/Files/NASAA\\_Report\\_0809.pdf](http://www.nasaa.org/content/Files/NASAA_Report_0809.pdf).

78. Alan E. Korpady, *The Proposed Uniform Franchise Act: The State Administrator's Viewpoint*, 5 FRANCHISE L.J. 13, 13 (1986); see also discussion *supra* note 76.

79. Korpady, *supra* note 78, at 15. From the regulatory perspective, the relationship laws address the critical imbalance of power and information, and the failure to regulate the stronger party was an invitation for abusive practices.

80. *Id.* at 14. The theory being that civil lawsuits provide an inadequate remedy because they improperly place the burden on the party least able to afford the cost of enforcement (the franchisee).

81. *Id.* As an organization, NASAA had a vested interest in protecting the institutions of its member states. More than a few critics noted that there was little incentive to dispose of registration laws in NASAA member states because of the substantial revenue generated by franchise filing fees. For example, at the time the UFA was proposed, franchise fees comprised 2% of South Dakota's entire state revenue stream. Bollinger, *supra* note 64, at 4. Reviewing registration applications also gave state administrators the ability to retain staff members at a time when the nation was going through a steep decline in securities filings. *Id.*

82. Barkoff, *supra* note 65.

83. Bollinger, *supra* note 64, at 3.

Despite NASAA protestations to the contrary, it is widely perceived that the MFIA was a reactionary response by franchisees and state regulators to the favorable franchisor provisions in the UFA.<sup>84</sup> This view is supported by the secrecy surrounding the initial drafting of the MFIA and the complete lack of input sought from industry sources.<sup>85</sup> In addition, on October 9, 1988, NASAA issued a formal resolution opposing the adoption of the UFA in its member states,<sup>86</sup> which, for all practical purposes, destroyed any hope that the UFA might be adopted and become the uniform standard for franchise law.<sup>87</sup> As such, when the initial draft of the MFIA was finally released on July 17, 1989, it was widely panned as biased towards franchisees. Redoubling its efforts, NASAA convened a new drafting committee comprised of state securities administrators to revise the initial draft.<sup>88</sup>

The final version of the Act, adopted in 1990, was quite different from the original proposal, dropping most of the relationship provisions.<sup>89</sup> However, the Act also modified the definition of “franchise” in such a way that it posed the potential for radically increasing the number and type of relationships that qualify as a franchise.<sup>90</sup> The MFIA’s other somewhat controversial provision was the requirement that franchisors

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84. Byron E. Fox & Peter I. Hoppenfeld, *A Review of NASAA’s Model Franchise Investment Act*, 9 FRANCHISE L.J. 7, 7 (1989) (“Others have maintained that NASAA, unable in NCCUSL’s open deliberations to persuade the drafters of the Uniform Act to adopt their views, sought a vehicle for articulating their positions without encumbrance or dissent.”); see also Bollinger, *supra* note 64, at 4 (stating that simple notice filing under the UFA was unacceptable to state regulators).

85. *Id.* For example, NASAA drafters did not reveal to the members of its own franchise industry advisory committee that the Act was being considered. *Id.* In addition, although NASAA officials testified before the FTC in the 1988 hearings related to potential new federal franchise standards, they did not discuss the proposed model act and did not reveal the proposed draft of the MFIA until shortly after the hearings. *Id.* But see Bollinger, *supra* note 64, at 4 (“While the Franchise Advisory Committee . . . was not a part of that drafting process, there was no effort to keep the drafting committee a secret.”).

86. Bollinger, *supra* note 64, at 3.

87. Since NASAA is comprised of the state regulators who would normally oversee and implement any state franchise regulations, NASAA’s support is crucial to legislative success.

88. Bollinger, *supra* note 64, at 4. Among those on the committee was Washington state’s then-securities administrator, Michael Stephenson. *Id.*

89. Dennis E. Wiczorek, *The Model Franchise Investment Act: A Field of Dreams*, 10 FRANCHISE L.J. 1, 25–26 (1991).

90. *Id.* At that time, most franchise statutes defined a franchise as consisting of three components: (1) a marketing plan; (2) a franchise fee; and (3) a trademark license. All three components were necessary to establish the existence of a franchise (and were prerequisites to the application of any requirement to register or disclose). Most state franchise laws defined marketing plans as concrete plans for the operation of a business, such as pricing plans, sales techniques, training, and promotional activities. But the MFIA expanded marketing plans to include prescribed or *suggested* plans, thereby increasing the reach of franchise laws to relationships where the assistance or guidance provided is not even required by product distributor. See *id.* at 26 (citing MODEL FRANCHISE INV. ACT § 3(g)(i)(A) (1990)).

register their franchise offerings in every state in which they intend to do business.<sup>91</sup> Other than these provisions, however, the remainder of the Act was better received than the UFA.

By the time NASAA completed the MFIA in 1990, the momentum to enact uniform national franchise laws had dissipated. Although the Act was substantively sound, it remained tinged by the belief that it had been drafted in secret in an effort to counter the UFA. As a result, it met with a similarly tepid response in most jurisdictions, and has had no greater success than the UFA in generating the type of uniform franchise regulation that was initially sought by franchising visionaries.

Today, both the UFA and MFIA have been resigned to the dustbin of history.<sup>92</sup> Neither the UFA nor the MFIA have retained the continued support of their respective drafting bodies, and there are no efforts underway to enact either of them. Despite their ineffectiveness, they remain an important footnote in Washington franchise history because, unlike most other jurisdictions, Washington did amend its franchise laws as a result of the uniform and model acts. Consequently, they have had an appreciable impact on the state of franchise law in Washington.

### *C. The Washington Legislature's 1991 Amendments to FIPA*

At its inception, FIPA was relatively novel and unprecedented, as Washington was just the second state in the nation, following California, to enact franchise legislation. As other states and the federal government began to regulate franchises, the standard metrics for defining the key issues in franchise law came into focus. Because FIPA did not benefit from this national evolution of franchise law, it contained a number of unique provisions that made Washington an outlier among the states that regulated franchising. Consequently, in 1986, the chairman of Washington state's House Committee on Labor and Commerce asked the Washington State Bar Association to form a committee<sup>93</sup> to draft revisions to FIPA.<sup>94</sup>

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91. MODEL FRANCHISE INV. ACT § 5 (1990).

92. *Cf.* Interview by News Editors and Broadcasters with Ronald Reagan, President of the United States of America, Washington D.C. (Dec. 11, 1987), available at <http://www.reagan.utexas.edu/archives/speeches/1987/121187a.htm>.

93. See *An Act Relating to Franchise Investment Protection: Hearing on SB 5256-S Before the H. Comm. on Commerce & Labor*, 1991 Leg., 52nd Sess. (Wash. 1991) (statement of C. Kent Carlson, chairman of the WSBA Committee). Formed in 1987, the WSBA Franchise Act Revision Committee (WSBA Committee) was chaired by securities attorney C. Kent Carlson, and was composed primarily of practicing attorneys that specialized in representing franchisees and franchisors. *Id.* The WSBA Committee's membership also included a law professor and a representative of the Washington State Securities Division, the administrative agency charged with regulating franchising. *Id.* Originally, regulatory authority over FIPA was vested in Washington's Department of Motor Vehicles. Franchise Investment Protection Act, ch. 252, § 1(3), 1971 Wash. Sess. Laws, 1st Ex.

The Washington State Bar Association Franchise Act Revision Committee (WSBA Committee) set four goals in drafting the amendments.<sup>95</sup> First, they wanted to make FIPA's provisions clear and predictable so that anyone desiring to franchise in Washington would know how to comply with the law.<sup>96</sup> Second, the committee sought to make Washington law consistent with other jurisdictions and the FTC rules.<sup>97</sup> In doing so, the committee gave significant weight to the terms of the UFA and the MFIA.<sup>98</sup> Third, the committee wanted to minimize the disadvantages and disincentives that made FIPA a deterrent to using franchising as a business model.<sup>99</sup> Primarily, the committee argued that this goal could be best achieved by creating uniformity with other states that regulate franchising.<sup>100</sup> Finally, the committee wanted to maintain the structure of FIPA by specifically retaining the statute's registration requirements and preserving the statute's relationship provisions.<sup>101</sup>

Ultimately, most of the language for the amended provisions was taken directly from the MFIA.<sup>102</sup> Consequently, although the 1991 amendments made FIPA more consistent with state and federal standards, Washington remains a unique and challenging environment for

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Sess. 1128. In 1979, the Department of Licensing assumed control over franchise regulation. *See An Act Relating to State Government*, ch. 158, § 83, 1979 Wash. Sess. Laws 894, 946. Ultimately, regulatory authority over FIPA was vested in the Department of Financial Institutions when the agency was created in 1993. *See An Act Relating to Technical Corrections made Necessary by the Creation of the Department of Financial Institutions*, ch. 92, § 3, 1994 Wash. Sess. Laws 305, 307.

94. The WSBA Committee spent three years reviewing the two uniform acts and the federal franchise rules before submitting a draft of proposed amendments to FIPA to the legislature in 1990. *See An Act Relating to Franchise Investment Protection: Hearing on SB 5256-S Before the H. Comm. on Commerce & Labor*, 1991 Leg., 52nd Sess. (Wash. 1991) (statement of C. Kent Carlson, chairman of the WSBA Committee). When the legislature failed to report a bill to the governor before the close of the session, the WSBA Committee spent another year making revisions to the proposed amendments, and returned during the 1991 session with a final proposed bill. *Id.*

95. *Id.*

96. *Id.*

97. *Id.*

98. *Id.*

99. *Id.*

100. *Id.*

101. *Id.* The committee's insistence on maintaining the existing regulatory structure was arguably contrary to the goal of minimizing disincentives to franchising. Testifying before the House Committee on Commerce and Labor, Gerald Farley of the International Franchise Association (IFA) stated that although the IFA did not have any fundamental disagreement with the proposed amendments, the amendments would neither lower any barriers to operation by franchisors, nor increase the likelihood that franchisors would do business in Washington. *An Act Relating to Franchise Investment Protection: Hearing on SB 5256-S Before the H. Comm. on Commerce & Labor*, 1991 Leg., 52nd Sess. (Wash. 1991).

102. It is unsurprising that the bulk of the language added to FIPA in 1991 came from the MFIA. Washington's securities administrator at that time was Michael Stephenson, a proponent of the MFIA and amendments to FIPA, who was also a key member of the NASAA drafting committee that prepared the model act. *See Bollinger, supra* note 64, at 4.

franchisors. In many respects, FIPA also presents significant legal challenges, as there are few states with similar laws for comparison. In any event, the 1991 FIPA amendments significantly altered a number of key issues in Washington law—issues that Professor Chisum never addressed in his article on the original Act. The following is a discussion of the most significant changes to the statute.

### 1. Amendments to Definitions

A number of terms were redefined by the 1991 amendments to the statute. Significantly, the legislature redefined the term “franchise,” narrowing it in scope.<sup>103</sup> Prior to 1991, a franchise was defined as an oral or written contract or agreement where: (1) a person grants to another person a license to use a trade name, service mark, trademark, or related characteristic; (2) there is a community of interest<sup>104</sup> in the business; and (3) the franchisee is required to pay a franchisee fee.<sup>105</sup> The 1991 amendments modified both the first and second elements of a franchise. First, instead of merely requiring a license to *use* a trademark or related characteristic, FIPA now requires that the operation of the business be *substantially associated* with a trademark.<sup>106</sup> Under the prior definition, courts concluded that it was irrelevant whether the franchisee was required, or merely permitted, to use the mark.<sup>107</sup> Now, the amendment relieves an alleged franchisor from compliance with FIPA’s requirements where use of a mark is merely permissive, at least until that use renders the business *substantially associated* with that mark.<sup>108</sup> Second, the leg-

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103. H.R. 5256, 1991 Leg., 52nd Sess. 2 (Wash. 1991).

104. FIPA defined community of interest as “a continuing financial interest between the franchisor and franchisee in the operation of the franchise business.” Franchise Investment Protection Act, ch. 252, § 1(2), 1971 Wash. Sess. Laws, 1st Ex. Sess. 1128. This subjective analysis has been dropped in favor of the more objective trademark association requirement.

105. *Id.* § 1(4). See also *Lobdell v. Sugar N’ Spice, Inc.*, 33 Wash. App. 881, 889–93, 658 P.2d 1267 (1983).

106. WASH. REV. CODE § 19.100.010(4)(a)(ii) (2008) (emphasis added).

107. See *Lobdell*, 33 Wash. App. at 887–88.

108. This reading of the statute is also supported by the legislative history of the amendments to the Act. The WSBA Committee drafting the franchise act revisions relied heavily on the UFA and MFIA. See *An Act Relating to Franchise Investment Protection: Hearing on SB 5256-S Before the S. Comm. on Law & Justice*, 1991 Leg., 52nd Sess. (Wash. 1991) (statement of C. Kent Carlson, chairman of the WSBA Committee). The UFA definition of a franchise, which was adopted by the legislature, mandates that the business is only a franchise if the operation of the business “is substantially associated” with a trademark. UNIF. FRANCHISE & BUS. OPPORTUNITIES ACT § 101(7)(i)(B) (1987). Conversely, the MFIA definition is permissive, stating that the franchise agreement “allows the franchise business to be substantially associated . . .” MODEL FRANCHISE INV. ACT § 3(g)(i)(C) (1990). The adoption of the UFA definition is particularly significant given that the majority of the amendments adopted by the drafting committee came from the MFIA. The tension between the two acts is a recurrent theme in the 1991 FIPA amendments. See, e.g., discussion *infra* note 109. See also discussion *infra* Part IV.A, for additional information about the definition of a franchise.

islature replaced the “community of interest” requirement with the requirement of a marketing plan “prescribed or suggested” by the franchisor.<sup>109</sup> This revision brought Washington in line with other jurisdictions, making it easier for Washington courts to rely on out-of-state precedent for the definition of a franchise.

The legislature also adopted a number of other new definitions, most of which it took verbatim from the MFIA.<sup>110</sup> The MFIA’s definitions adopted by the legislature are uniformly broader and more inclusive than the counterpart definitions in the UFA, tending to subject more businesses and individuals to FIPA’s jurisdiction.<sup>111</sup>

The only truly novel definition modified by the legislature was “franchise broker.”<sup>112</sup> Prior to 1991, a franchise broker included any person engaged in the sale of franchises,<sup>113</sup> but the amendment modified the section to exclude from the definition franchisors, subfranchisors, and their officers, directors and employees.<sup>114</sup> Although this amendment lessened the burden on franchisors by exempting their officers, directors and employees from having to register as franchise brokers,<sup>115</sup> the legislature created additional corresponding requirements that have resulted in a net increase in the cost of doing business in Washington.<sup>116</sup>

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109. WASH. REV. CODE § 19.100.010(4)(a)(i) (2008). This change also underscores the struggle between the language in the two model acts. A business only qualified as a franchise under the UFA if the marketing plan is “prescribed in substantial part by the franchisor.” UNIF. FRANCHISE & BUS. OPPORTUNITIES ACT § 101(7)(i)(A) (1987). Thus, under the UFA, a business arrangement only qualifies as a franchise if the bulk of the marketing plans and designs are controlled by the purported franchisor. Under the MFIA, a marketing plan need only be “suggested” by the franchisor for the business to qualify as a franchise. MODEL FRANCHISE INV. ACT § 3(g)(i)(A) (1990). At the time of the adoption of the MFIA, this constituted a significant expansion of the definition of a franchise, encompassing even the mere suggestion about how to conduct business. See Fox & Hoppenfeld, *supra* note 84, at 8. The expansive definition had also recently been rejected by a court in Wisconsin. KIS Corp. v. Payne, Bus. Franchise Guide (CCH) ¶ 8,617 (Wis. Cir. Ct. July 18, 1986). See also WIS. ADMIN. CODE § 31.01(4) (2008) (describing elements of marketing plans “prescribed” by the franchisor). The Washington legislature’s adoption of the definition in the MFIA indicates an intent to expand the reach of Washington franchise laws to include distributorships where the marketing plan is merely suggested.

110. Compare MODEL FRANCHISE INV. ACT §§ 3(d), (m), (n) (1990), with WASH. REV. CODE § 19.100.010(2) (2008) (“affiliates”), *id.* § 19.100.010(5) (“marketing plans”), and *id.* § 19.100.010(9) (“subfranchises”).

111. Compare MODEL FRANCHISE INV. ACT §§ 3(d), (m), (n) (1990), with UNIF. FRANCHISE & BUS. OPPORTUNITIES ACT §§ 101(3), (12) (1987).

112. WASH. REV. CODE § 19.100.010(11) (2008).

113. Franchise Investment Protection Act, ch. 252, §1(9), 1971 Wash. Sess. Laws, 1st Ex. Sess. 1129.

114. An Act Relating to Franchise Investment Protection, ch. 226, § 1(11), 1991 Wash. Sess. Laws. 1125.

115. See WASH. REV. CODE § 19.100.140 (2008).

116. Specifically, although the legislature decreased costs to franchisors by exempting them from the burden of registering their office agents as franchise brokers, the legislature was unwilling to pass the amendment without creating a new stream of revenue to replace the lost franchise broker

## 2. Jurisdictional Scope of FIPA

The 1991 amendments also clarified the state's territorial reach over FIPA claims. As originally enacted in 1972, FIPA was limited in its application to conduct occurring "in this state."<sup>117</sup> But prior to 1991, FIPA contained no definition for what constituted conduct occurring "in this state."<sup>118</sup> The amendments included a definition of the key phrase "in this state," and now it is clear that FIPA applies to franchise offers (1) directed into, and received in, Washington; (2) originating in Washington that violate the law of the state into which they are directed; (3) directed to Washington residents; and (4) relating to businesses to be located or operated in Washington.<sup>119</sup> The uniform acts also have provisions similar to numbers one (offers directed into the state) and four (offers covering businesses to be operated within the state).<sup>120</sup> But the remaining territorial provisions significantly expand Washington's potential jurisdictional authority beyond the limitations contemplated by the uniform acts,<sup>121</sup> and may violate constitutional limitations on state regulatory authority.<sup>122</sup> For example, it is unclear what interest the state of Washington has in regulating the sale of franchises by Washington-based franchisors to franchisees located in other states. Presumably, if the foreign state's franchise regulations were *more* stringent than FIPA,

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registration fees. See *An Act Relating to Franchise Investment Protection: Hearing on SB 5256-S Before the H. Comm. on Commerce & Labor*, 1991 Leg., 52nd Sess. (Wash. 1991) (statement of Michael Stephenson, Washington state securities administrator). To ensure the bill would be revenue neutral, the state Securities Division proposed adopting an annual \$50 fee (later revised upward to \$100) for franchisors filing a notice of exemption from FIPA's registration requirements. *Id.* The revenue from this source (and the corresponding regulatory burden on franchisors) has likely exceeded the cost of registering independent franchise brokers, which imposed relatively little cost to franchisors.

117. See, e.g., Franchise Investment Protection Act, ch. 252, § 2, 1971 Wash. Sess. Laws, 1st Ex. Sess. 1129.

118. *Id.* Professor Chisum noted that the legislature's failure to include a definition for the key phrase "in this state" was an unfortunate omission. Chisum, *supra* note 1, at 337-38. Chisum advocated for the adoption of California's definition of the territorial coverage of its franchise law, which expressly defines when conduct occurs "in this state," for purposes of that act. *Id.* at 337-39.

119. WASH. REV. CODE § 19.100.020(2) (2008). See also discussion *infra* note 267 for information about the effect of FIPA's territorial limitations on a contractual choice of law provision.

120. MODEL FRANCHISE INV. ACT §§ 4(c)-(d) (1990); UNIF. FRANCHISE & BUS. OPPORTUNITIES ACT §§ 102(c)-(d) (1987).

121. In fact, the MFIA contains an explicit provision exempting the offer or sale of a franchise sold to out-of-state residents operating the franchise outside of the state. MODEL FRANCHISE INV. ACT § 7 (1990).

122. In response to these potential constitutional concerns raised in the uniform acts, the legislature did adopt one limitation on the scope of state jurisdiction under FIPA. See WASH. REV. CODE § 19.100.020(4) (2008) (stating that an offer to sell is not made for purposes of FIPA where the offer appears in a newspaper having more than two-thirds of its regular circulation outside the state during the twelve months before the offer is published, or if the offer is in a broadcast transmission originating outside the state).

then the franchisee located in that state would reap the benefit of the foreign state's laws. But based on this provision of FIPA, the franchisor may argue that FIPA applies to such a transaction, to the exclusion of the foreign state law.<sup>123</sup> This jurisdictional question is not as significant for claims arising out of offers made to Washington residents because there is a stronger case to be made that the state has an interest in protecting the rights of its citizens.<sup>124</sup>

### 3. Registration Exemptions

Franchisors that meet one of the specifically enumerated FIPA exemptions do not need to comply with FIPA's registration requirements and need only file a notice of exemption and pay a small fee.<sup>125</sup> The legislature amended these provisions, modifying a number of existing exemptions, removing one, and adding two new exemptions.<sup>126</sup> The exemptions for franchise sales by franchisees,<sup>127</sup> and sales made pursuant to state law,<sup>128</sup> were modified for clarification and consistency purposes. The so-called "big-boy" exemption (for large franchisors that satisfy specific requirements) was also modified to maintain consistency with the FTC rule requirement<sup>129</sup> and to require all large franchisors to pay a

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123. A franchisor raised a similar argument in *Burger King Corp. v. Austin*, 805 F. Supp. 1007 (S.D. Fla. 1992). In that case, the franchisee was located in Georgia. *See id.* at 1022. The franchise agreement contained a choice of law clause applying Florida law. *Id.* But the Florida Franchise Act protected only franchisees doing business in Florida. FLA. STAT. ANN. § 817.416 (West 2004). The franchisor argued that no franchise law applied to protect the franchisee. *See Burger King Corp.*, 805 F. Supp. at 1022. The court, perhaps bothered by the unfairness of the situation, employed twisted logic to conclude that the parties intended for the franchisee to be regarded as doing business in Florida, and applied the Florida protections. *Id.* at 1023. Although the court reached a fair result, another court that is less willing to bend the rule of law could conceivably find in favor of the franchisor in this type of situation.

124. A number of other states that regulate the sale of franchises have similar provisions. *Cf.* CAL. CORP. CODE § 31013(a) (2008); MD. CODE ANN., BUS. REG. § 14-203(a)(2)(i) (West 2008); MICH. COMP. LAWS § 445.1504(2) (2008); N.Y. GEN. BUS. LAW § 681(12)(a) (McKinney 2008); N.D. CENT. CODE § 51-19-02(14)(b)(1) (2008); OR. REV. STAT. § 650.015(1) (2008); S.D. CODIFIED LAWS § 37-5A-7.1 (2008).

125. WASH. REV. CODE § 19.100.030 (2008).

126. *Id.*

127. *Id.* § 19.100.030(1).

128. *Id.* § 19.100.030(2) (sales by executors, administrators, sheriffs, marshals, receivers, trustees in bankruptcy, guardians, conservators, and court-ordered sales).

129. *Id.* § 19.100.030(4). Washington law previously called for delivery of the franchise disclosure document within forty-eight hours prior to execution of the franchise agreement. The amendment changed the time period to ten business days, consistent with the then-existing FTC rule. However, in 2007, the FTC amended the Franchise Rule, changing the delivery time from ten business days to fourteen calendar days. *See Disclosure Requirements and Prohibitions Concerning Franchising*, 72 Fed. Reg. 15,544, 15,545 (Mar. 30, 2007) (to be codified at 16 C.F.R. § 436.2(a)). As of the drafting of this Article, Washington has not adopted a similar amendment, but likely will in the future.

new exemption filing fee.<sup>130</sup> The legislature removed the exemption that applied to motor vehicle rental organizations.<sup>131</sup>

In addition, the legislature created two new exemptions from registration—one for sales of franchises to sophisticated investors,<sup>132</sup> and another for sales to existing franchisees.<sup>133</sup> The new provisions were adopted to make FIPA more consistent with the type of exemptions available under state securities laws.<sup>134</sup>

#### 4. Registration Applications

Although the registration process changed significantly in 1991, the changes greatly simplified the process. Prior to 1991, FIPA contained a lengthy list of materials that had to be submitted with an application for registration.<sup>135</sup> Those requirements were effectively replaced by the disclosure requirements of NASAA's Uniform Franchise Offering Circular (UFOC) long before the statute was amended.<sup>136</sup> FIPA's current disclo-

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130. See discussion *supra* note 116 for more information about the legislature's decision to create a new filing fee.

131. An Act Relating to Franchise Investment Protection, ch. 226, § 3(5), 1991 Wash. Sess. Laws 1130–31. This exemption was the product of intense lobbying by the rental car industry that convinced the legislature to amend FIPA in 1972, before the 1971 act became effective. See Fletcher, *supra* note 22, at 53 (“Hertz, Avis and National car rental companies . . . objected to the coverage of the proposed act with respect to the business of renting or leasing motor vehicles through an interdependent system of direct and franchised operations. Due to their insistence, a new [exemption] was added.”). Chisum, *supra* note 1, at 345 n.273 (“[This exclusion] appear[s] to be the obvious result of the powerful lobbying efforts of . . . automobile manufacturers.”); see also An Act Relating to Franchises, ch. 116, § 2(5), 1972 Wash. Sess. Laws, 2d Ex. Sess. 265. Although there was no apparent reason why car rental companies should have been exempted from FIPA, there was no evidence in the record to suggest that there was any abuse of the exemption by the industry. See *An Act Relating to Franchise Investment Protection: Hearing on SB 5256-S Before the S. Comm. on Law & Justice*, 1991 Leg., 52nd Sess. (Wash. 1991) (statement of Gary Duvall, member of the WSBA Committee). It is therefore questionable whether regulation of the industry was needed, but the WSBA Committee decided to strike this exemption in an effort to increase state revenue and improve consistency with the laws of other jurisdictions.

132. WASH. REV. CODE § 19.100.030(5) (2008). The definition of what constitutes an accredited investor was left to the discretion of the director of the department of financial institutions, and has since been adopted by rule. WASH. ADMIN. CODE 460-8-108 (1992). The language adopted by the Department was taken almost verbatim from the MFIA. MODEL FRANCHISE INV. ACT § 6(d) (1990).

133. WASH. REV. CODE § 19.100.030(6) (2008).

134. See *An Act Relating to Franchise Investment Protection: Hearing on SB 5256-S Before the S. Comm. on Law & Justice*, 1991 Leg., 52nd Sess. (Wash. 1991) (statement of C. Kent. Carlson, chairman of the WSBA Committee).

135. See Franchise Investment Protection Act, ch. 252, § 4, 1971 Wash. Sess. Laws, 1st Ex. Sess. 1132, amended by ch. 116, 1972 Wash. Sess. Laws, 2d Ex. Sess. 226.

136. Prior to the adoption of the FTC rule, franchisors faced a patchwork of registration and disclosure rules in a number of states. To encourage consistency, in September 1975, the Midwest Securities Commissioners Association (the predecessor to NASAA) approved a Uniform Franchise Offering Circular (UFOC) that encompassed all of the various requirements for state registration and disclosure. See Mark H. Miller, *Franchising in Texas*, 14 ST. MARY'S L.J. 301, 307 (1983); James

sure requirements, in place since the 1991 amendments, have themselves been replaced by the Franchise Disclosure Document (FDD).<sup>137</sup> Because the FDD is already a required disclosure document under the FTC rule, repeal of the outdated list in favor of the FDD has streamlined the process for submitting registration applications.<sup>138</sup>

FIPA was also amended to require franchisors to submit amended applications as soon as reasonably possible in the event of material changes to the franchisor's financial condition.<sup>139</sup>

### 5. Advertisements

The legislature also expanded the Securities Division's regulatory authority by enacting a provision that requires franchisors to file all advertisements with the state seven days before publication or airing.<sup>140</sup> This change, a favorite among state securities administrators, extends the state's role in regulating franchise sales to include reviewing and approving of proposed advertising. It provides another method by which state officials may monitor and control franchise sales in the state, and the provision is similar to one proposed in the MFIA.<sup>141</sup>

### 6. Negotiated Changes

One of the major revisions to FIPA made it permissible for the parties to negotiate changes to the franchise agreement.<sup>142</sup> Prior to 1991, it

R. Conohan, *The New Uniform Franchise Offering Circular: The Franchisor Perspective*, 14 FRANCHISE L.J. 30, 30 (1994). Over the next two decades, the UFOC became the standard for disclosure, supplanting state statutory requirements as the standard disclosures required by state regulators. In fact, Washington's 1991 amendments to FIPA explicitly replaced the voluminous registration application materials with the UFOC format. See discussion *infra* note 137. NASAA adopted a revised UFOC format on April 25, 1993, that became effective January 1, 1995. See Stephen W. Maxey, *The New Uniform Franchise Offering Circular: The Regulatory Perspective*, 14 FRANCHISE L.J. 25 (1994).

137. WASH. REV. CODE § 19.100.040(1)(a) (2008). The language of FIPA still requires disclosure through the UFOC format. *Id.* However, as a result of the changes implemented in the FTC's 2007 amendments to the franchise rule, NASAA has replaced the standard UFOC with the franchise disclosure document (FDD). See N. AM. SEC. ADM'R ASS'N, 2008 FRANCHISE REGISTRATION AND DISCLOSURE GUIDELINES 1 (2008) [hereinafter NASAA GUIDELINES], available at <http://www.nasaa.org/content/Files/2008UFOC.pdf>. Despite the linguistic discrepancy, the Washington Securities Division will accept the new FDD form unless the legislature directs otherwise. See discussion *supra* note 129.

138. See discussion *infra* Part IV.B for more information about the registration process.

139. WASH. REV. CODE § 19.100.070(3) (2008). See discussion *infra* Part IV.B concerning updates to reflect material changes.

140. WASH. REV. CODE § 19.100.100 (2008). In Washington, franchising is regulated by the Department of Financial Institutions through its Securities Division. *Id.* § 19.100.010(3), .040.

141. See MODEL FRANCHISE INV. ACT § 12 (1990) (requiring franchisors to file all advertisements five business days before publication or airing).

142. WASH. REV. CODE § 19.100.184 (2008).

was arguably an unfair or deceptive act for a franchisor and a franchisee to negotiate changes to the franchise agreement because FIPA explicitly prohibits a franchisor to discriminate between franchisees.<sup>143</sup> The discrimination provision of the bill of rights was amended to acknowledge that negotiated changes are not an unfair or deceptive act, so long as the franchisee initiates the negotiations.<sup>144</sup>

As originally drafted by the WSBA Committee, the provision on negotiated changes was not limited to negotiations initiated by the franchisee;<sup>145</sup> instead, it referred generally to negotiations between the parties.<sup>146</sup> However, in discussions just prior to the first legislative committee hearing, state securities administrators proposed adding the language as an added level of protection for franchisees.<sup>147</sup> The language was added by amendment, but it is unclear whether this has had the intended effect of protecting franchisees. For example, a franchisor that agrees to negotiate terms is at a significantly greater risk of being held liable for a FIPA violation if a court later determines that the franchisor initiated the negotiations. Therefore, as it is often uncertain when a negotiation is truly “initiated,” and by whom, a franchisor mindful of FIPA’s restrictions has little incentive to negotiate changes with a franchisee.<sup>148</sup>

## 7. Waiver

FIPA has always had a strong policy against waiver of any franchisee rights, voiding any provision that purports to waive compliance with FIPA’s requirements.<sup>149</sup> The strong waiver policy was originally intended to prohibit franchisors from drafting form franchise agreements that purport to prospectively waive the protections of FIPA.<sup>150</sup> However,

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143. *Id.* § 19.100.180(2)(c).

144. *Id.*

145. See *An Act Relating to Franchise Investment Protection: Hearing on SB 5256-S Before the S. Comm. on Law & Justice*, 1991 Leg., 52nd Sess. (Wash. 1991) (statement of C. Kent. Carlson, chairman of the WSBA Committee).

146. Neither the MFIA nor the UFA limits the validity of negotiated changes to those initiated by the franchisee. See MODEL FRANCHISE INV. ACT § 10 (1990); UNIF. FRANCHISE & BUS. OPPORTUNITIES ACT § 306 (1987).

147. See *An Act Relating to Franchise Investment Protection: Hearing on SB 5256-S Before the S. Comm. on Law & Justice*, 1991 Leg., 52nd Sess. (Wash. 1991) (statement of C. Kent. Carlson, chairman of the WSBA Committee).

148. Indeed, a franchisor that negotiates changes with a franchisee must also contend with FIPA’s prohibition on discrimination between franchisees. See WASH. REV. CODE § 19.100.180(2)(c) (2008). Absent ironclad proof that the new franchisee “initiated” the negotiations, the franchisor may run into trouble with other franchisees in the system that cry foul over the different or more favorable terms negotiated with the new franchisee. See also discussion *infra* Part V.D.2.c.

149. WASH. REV. CODE § 19.100.220 (2008).

150. See Chisum, *supra* note 1, at 375–76.

by the early 1990s, it was apparent that the original rule was overly broad because it was never intended to prohibit the settlement of disputes between franchisors and franchisees. The amended version of the statute clarified that a release of claims made in the course of a settlement of a bona fide dispute between the franchisor and franchisee, arising after the franchisee agreement has taken effect, and in which the franchisee is represented by independent legal counsel, is not a violation of FIPA's anti-waiver policy.<sup>151</sup> The legislature also added a specific waiver policy, explicitly identifying choice of law provisions prescribing foreign law as the type of waiver that is prohibited by FIPA.<sup>152</sup> The primary objective of these changes was to discourage franchisor efforts to coerce new franchisees into prospectively waiving their rights under FIPA.

### 8. Fundamental Policy

The FIPA amendments also identified FIPA as a "fundamental policy of the State of Washington."<sup>153</sup> Some commentators have concluded that this language was included in the statute as a means of incorporating longstanding illegality precedent.<sup>154</sup> The theory is that any contract, in this case the franchise contract, that is in violation of a fundamental policy of the state is illegal and therefore void and unenforceable.<sup>155</sup>

However, the fundamental policy language was not included in FIPA as a means of incorporating illegal contract concepts into the FIPA

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151. WASH. REV. CODE § 19.100.220. But see discussion *infra* at Part V.D.2.g, concerning the construction of this requirement.

152. WASH. REV. CODE § 19.100.220.

153. *Id.* § 19.100.220(c).

154. Howard R. Morrill, *The Unintentional Franchise*, WASH. ST. BAR ASS'N NEWS (Mar. 2003).

155. *Id.* An agreement that is void as an illegal contract is unenforceable. See, e.g., *Sherwood v. Wise*, 132 Wash. 295, 301–02, 232 P. 309 (1925). Thus, some commentators have argued that a franchisor's technical violation of FIPA, such as a failure to register, makes the franchise agreement void and unenforceable. See, e.g., Morrill, *supra* note 154. But this contention is incorrect. In general, a contract that violates a statutory business regulation is not void unless made so by the terms of the statute. *Ritter v. Shotwell*, 63 Wash. 2d 601, 606, 388 P.2d 527 (1964). Thus, the Washington Supreme Court has held that a franchisor's failure to comply with FIPA's registration requirements does not make the franchise agreement void, but merely voidable by the franchisee. *Allison v. Medicab Int'l, Inc.*, 92 Wash. 2d 199, 203–04, 597 P.2d 380 (1979) (citing *Fleetham v. Schneekloth*, 52 Wash. 2d 176, 180, 324 P.2d 429 (1958) (holding that a contract that violates a statutory regulation is not void unless expressly made so by terms of the statute)); see also *Harb v. Norrell Servs., Inc.*, Bus. Franchise Guide (CCH) ¶ 10,185 (W.D. Wash. Jan. 29, 1993) (a franchisor's failure to register does not render the resulting franchise void, only voidable). However, a franchisee's power to void the franchise agreement for failure to register must be exercised within the two year statute of limitations applicable to technical violations of FIPA. *Rand v. CM Franchise Sys., Inc.*, No. 61828-8, 2009 WL 667227 (Wash. Ct. App. Mar. 16, 2009); see also discussion *infra* Part V.B.3, for analysis of the applicable statute of limitations. This is consistent with FIPA's statutory rescission remedy for such violations. See WASH. REV. CODE § 19.100.190(2) (2008).

analysis. Instead, the language was an attempt by the revision committee to avoid choice of law problems<sup>156</sup> that arise when courts in Washington and other jurisdictions are interpreting FIPA in relation to franchise transactions that happen outside the state.<sup>157</sup> In particular, the committee was motivated by a then-recent Washington court decision in which the trial court held on summary judgment that California law applied to a dispute between a Washington franchisee and California franchisor.<sup>158</sup> In short, the motivating force behind the new amendment was to avoid choice of law problems; therefore, the amended provision should not be interpreted as creating additional substantive claims or rights that were never intended by the legislature or drafting committee.

### 9. Statute of Limitations

FIPA originally contained no express statute of limitations, and it contains no limitations period today. The legislature did pass a provision that would have created a one-year limitation period for any claim of rescission for failure to register, and a three-year limitation period for any other action under FIPA.<sup>159</sup> But Governor Booth Gardner vetoed the provision, so it was not included in the amended Act.<sup>160</sup>

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156. In general, a principal factor analyzed by the courts when determining whether to apply a particular state's laws to a dispute is whether the state law in question represents a fundamental policy of that state. See, e.g., *Rutter v. BX of Tri-Cities, Inc.*, 60 Wash. App. 743, 746, 806 P.2d 1266 (1991). By declaring this in the legislative text, the drafters sought to avoid an adverse decision by a court concluding that FIPA was not a fundamental policy of the state.

157. See *An Act Relating to Franchise Investment Protection: Hearing on SB 5256-S Before the S. Comm. on Law & Justice*, 1991 Leg., 52nd Sess. (Wash. 1991) (statement of C. Kent. Carlson, chairman of the WSBA Committee).

158. *Id.* (stating that the provision was "purely aimed at that case"). Interestingly, the trial court decision in what appears to be the case in question was overruled on appeal on March 26, 1991, just weeks after the committee's January 29, 1991, hearing, but before the Governor officially signed into law the FIPA amendments in May. See *Rutter*, 60 Wash. App. at 746 ("Washington Courts will not give effect to an express choice of law clause if application of the law of the chosen state would be contrary to a fundamental policy of Washington and Washington has a materially greater interest in the determination of the particular issue.").

159. An Act Relating to Franchise Investment Protection, ch. 226, § 15, 1991 Wash. Sess. Laws 1139.

160. Governor Booth Gardner, Veto Message on E.S.S.B. 5256, ch. 226, 1991 Wash. Sess. Laws 1141 (May 16, 1991). The legislative history is important nonetheless, as it implicates the appropriate limitations period that should apply. Testimony about the proposed statute of limitations periods for FIPA during the 1991 amendment hearings was contentious. See *An Act Relating to Franchise Investment Protection: Hearing on SB 5256-S Before the H. Comm. on Commerce & Labor*, 1991 Leg., 52nd Sess. (Wash. 1991) (statement of Michael Stephenson, Washington state securities administrator). As originally presented to the legislature in 1990, the WSBA Committee proposed a two-year limitations period for rescission actions, and a four-year period for all other claims. *Id.* During the 1990 legislative session, the Act was amended to one year and to three years, but failed to pass the legislature. *Id.* When the WSBA Committee returned to the legislature in 1991, the proposed revisions incorporated the new limitations period, as amended by the previous

The last thirty-seven years have seen significant changes to franchise law in Washington. But during that same period, there has been a dearth of commentators, articles, and cases to explain these significant changes. The remaining sections of this article will take up this task, and will provide a roadmap for practitioners working in the field of franchising in Washington.

#### IV. THE CURRENT WASHINGTON REGULATORY SYSTEM

For those agreements that qualify as a “franchise,” FIPA imposes a three-part regulatory system. It requires pre-sale registration of franchise offerings, requires disclosure of certain information to prospective franchisees, and imposes limitations on the franchisor-franchisee relationship after the parties enter into their franchise agreement. Franchisors that fail to comply with or violate any of these provisions are subject to a broad array of penalties, both civil and criminal.

##### A. Definition of a Franchise

A “franchise” is an agreement, whether oral or written,<sup>161</sup> that satisfies the following three elements: (1) a “marketing plan” required or suggested by the franchisor or its affiliate; (2) “substantial association” of the business with a trademark, service mark, trade name, advertising, or other commercial symbol designating, owned by, or licensed by the franchisor or its affiliate; and (3) the payment of a “franchise fee,” either directly or indirectly, by the franchisee.<sup>162</sup> Each element is discussed in greater detail below.

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legislature. *Id.* State officials for the Securities Division were particularly opposed to the shorter limitations period, arguing that the original two-year/four-year period should be reinstated. *Id.* These protestations went unanswered and the shorter periods were passed by the legislature and sent to the Governor. An Act Relating to Franchise Investment Protection, ch. 226, § 15, 1991 Wash. Sess. Laws 1139. However, the Governor agreed with the longer limitations period proposed by the Securities Division and exercised his veto authority to eliminate the limitations period, stating that he favored uncertainty over the shorter time frame. Governor Booth Gardner, Veto Message on E.S.S.B. 5256, ch. 226, 1991 Wash. Sess. Laws 1141 (May 16, 1991) (“While I agree that providing greater certainty in the limitation of actions is desirable[,] . . . [a] veto of section 15 is necessary to assure continued consumer protection.”). There have been no subsequent amendments, and FIPA still contains no explicit limitations period. See discussion *infra* Part V.B.3 for additional information about the statute of limitations for claims under FIPA.

161. *Klinke v. Famous Recipe Fried Chicken, Inc.*, 94 Wash. 2d 255, 260, 616 P.2d 644 (1980) (holding that an oral franchise agreement can be binding, at least if it includes promise by the franchisor’s representative to enter into written agreement confirming terms).

162. WASH. REV. CODE § 19.100.010(4)(a) (2008). However, the statute expressly provides that the following are outside the scope of FIPA: (1) service charges to the issuer of a credit card; (2) actions or transactions permitted, prohibited, or regulated by the Insurance Commissioner; and (3) motor vehicle dealer franchise agreements subject to Washington’s motor vehicle dealer law. *Id.* § 19.100.010(4)(b).

### 1. Marketing Plan

The “marketing plan” element of the franchise definition imposes at least two requirements: (1) under the parties’ agreement, the franchisee must have been “granted the right to engage in the business of offering, selling, or distributing goods or services”; and (2) the parties’ agreement must contemplate that the business is to be conducted under a “marketing plan prescribed or suggested in substantial part by [the franchisor] or its affiliate.”<sup>163</sup>

FIPA’s definition of the term “marketing plan” provides that a “‘marketing plan’ means a plan or system concerning an aspect of conducting business.”<sup>164</sup> In addition, the statutory definition provides that a marketing plan *may* include one or more of the following characteristics:

- (a) Price specifications, special pricing systems or discount plans;
- (b) Sales or display equipment or merchandising devices; (c) Sales techniques; (d) Promotional or advertising materials or cooperative advertising; (e) Training regarding the promotion, operation, or management of the business; or (f) Operational, managerial, technical, or financial guidelines or assistance.<sup>165</sup>

These characteristics in some form or another have long been common to all distribution systems. To date, no court has provided any further guidance to the intended meaning of “marketing plan” under FIPA.<sup>166</sup> Although not universally consistent, most decisions from other jurisdictions construing similar or identical provisions have stressed that the key to the existence of a “marketing plan” is whether “[o]verall, [there is] a certain ‘level of control’ of the franchisee’s operation by the franchisor.”<sup>167</sup>

To determine whether the requisite level of control exists under the “marketing plan” prong of the franchise definition, the Connecticut Supreme Court has adopted the factors outlined in *Consumers Petroleum*

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163. *Id.* § 19.100.010(4)(a)(i).

164. *Id.* § 19.100.010(5).

165. *Id.*

166. In particular, it is unclear whether the legislature intended to differentiate franchises from conventional chains of distribution. For instance, manufacturers often, if not usually, provide their retailers or distributors with suggested resale pricing, point of sale advertising materials, or training regarding the use, maintenance, or marketing of their products. If the legislature had intended to capture those common practices, the legislature likely would have provided a less detailed definition of “marketing plan.” The more specific definition suggests that the legislature intended this to apply to means of distribution involving a higher degree of control or involvement from the would-be franchisor.

167. *Contractors Home Appliance, Inc. v. Clarke Distrib. Corp.*, 196 F.Supp.2d 174, 177 (D. Conn. 2002) (citing *Hartford Elec. Supply Co. v. Allen-Bradley Co.*, 736 A.2d 824, 833 (Conn. 1999)).

of *Connecticut, Inc. v. Duhan*.<sup>168</sup> Those factors include the level of control the putative franchisor has over the putative franchisee's hours and days of operation, advertising, lighting, employee uniforms, prices, trading stamps, hiring, sales quotas, and management training.<sup>169</sup> Courts have also looked at whether the franchisor has provided the franchisee with financial support, audited its books, or inspected its premises.<sup>170</sup>

Also, in *East Wind Express, Inc. v. Airborne Freight Corp.*, the Washington Court of Appeals held that under the "marketing plan" element, the franchisee must have been "granted the right to engage in the business of offering, selling, or distributing goods or services."<sup>171</sup> In that case, Airborne conducted a nationwide delivery service for packages.<sup>172</sup> Airborne sorted and routed the packages from a national distribution center in Ohio, delivering the packages to a local destination station.<sup>173</sup> Once at the destination station, the packages were delivered either by an Airborne employee or by an independent contractor under a cartage contract with Airborne, one of which was East Wind.<sup>174</sup> Under its contract, East Wind provided pick-up, transport, and delivery of shipments between Airborne's customers and Airborne's facilities in northern Oregon.<sup>175</sup> East Wind's drivers wore Airborne uniforms and its trucks displayed Airborne's logo.<sup>176</sup> East Wind also was required to maintain the trucks, uniforms, and logos according to standards established by

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168. 452 A.2d 123, 125 (Conn. Super. Ct. 1982). See also *Ackley v. Gulf Oil Corp.*, 726 F. Supp. 353, 365 (D. Conn. 1989); *Aurigemma v. Arco Petroleum Prods. Co.*, 698 F. Supp. 1035, 1039 (D. Conn. 1988); *McKeown Distribs., Inc. v. Gyp-Crete Corp.*, 618 F. Supp. 632, 642 (D. Conn. 1985); *Hartford Elec.*, 736 A.2d at 834.

169. *Hartford Elec.*, 736 A.2d at 834 (citing *Consumers Petroleum*, 452 A.2d at 125).

170. *Id. Accord Jerome-Duncan, Inc. v. Auto-By-Tel, L.L.C.*, 176 F.3d 904, 910-11 (6th Cir. 1999) (no marketing plan under agreement between auto dealer and internet referral service where referral service did not exercise authority or control over dealer's day-to-day business operations); *Hoosier Penn Oil Co. v. Ashland Oil Co.*, 934 F.2d 882, 885 (7th Cir. 1991) (motor oil distributor did not operate under a marketing plan where, *inter alia*, manufacturer had no control over the distributor's hiring of sales employees, training offered was not mandatory, and it imposed no sales quotas); *Bestest Int'l, Inc. v. Futrex, Inc.*, Bus. Franchise Guide (CCH) ¶ 11,915 (C.D. Cal. Aug. 14, 2000) (medical equipment distributor did not operate under a marketing plan where distributor was free to operate its own business; the fact that manufacturer made sales and marketing suggestions was insufficient to establish a marketing plan); *Inland Printing Co. v. A. B. Dick Co.*, Bus. Franchise Guide (CCH) ¶ 8,997 (W.D. Mo. Mar. 18, 1987) (on preliminary injunction motion, court determined distributor did not operate under marketing plan prescribed by manufacturer where it operated an independent business and made its own plans).

171. *East Wind Express, Inc. v. Airborne Freight Corp.*, 95 Wash. App. 98, 103, 974 P.2d 369 (1999).

172. *Id.* at 100.

173. *Id.*

174. *Id.*

175. *Id.*

176. *Id.* at 101.

Airborne.<sup>177</sup> East Wind merely delivered packages, either picking them up from the customer and delivering them to Airborne's sorting facility, or picking them up from the sorting facility and delivering them to the intended recipient.<sup>178</sup> Airborne billed the customer and was responsible for the package from pick-up to destination.<sup>179</sup> Additionally, "East Wind was 'not entitled to receive any portion of any charges made by Airborne to its shippers.'" <sup>180</sup> Rather, Airborne paid East Wind based on an average number of packages it carried per day.<sup>181</sup>

East Wind claimed its cartage contract was a "franchise" under FIPA, but the court disagreed.<sup>182</sup> As the court emphasized, Airborne's service is package delivery, which it marketed and sold directly to customers.<sup>183</sup> East Wind delivered and picked up some of Airborne's packages; it did not market or sell this service to individual customers.<sup>184</sup> Because East Wind merely provided a delivery service and had no participation in the contract of sale with the customers, Airborne had not granted East Wind the right to "offer, sell, or distribute transportation services to the customers who ship goods with Airborne."<sup>185</sup> Thus, under the court's interpretation of the marketing plan element, an agreement is not a franchise unless the would-be franchisee is granted the right to market and sell directly to customers. Merely servicing customers on behalf of a trademark owner is insufficient.

## 2. Substantial Association with a Trademark

The second element of the definition of a franchise requires a showing that the franchisee's business "is substantially associated with" a trademark or service mark licensed or owned by the franchisor or an affiliate.<sup>186</sup> Although there is no Washington case law on the question, by analogy to federal law, it is likely that a "fractional franchise" as defined by the FTC rule would not satisfy the trademark element of FIPA's franchise definition.<sup>187</sup> Also, when a franchisor company owns

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177. *Id.*

178. *Id.* at 100.

179. *Id.*

180. *Id.* at 100–01.

181. *Id.* at 101.

182. *Id.* at 105.

183. *Id.* at 104.

184. *Id.*

185. *Id.*

186. WASH. REV. CODE § 19.100.010(4)(a)(ii) (2008).

187. 16 C.F.R. § 436.1(g) (2008). A "fractional franchise" occurs when the business is associated with multiple marks, and the would-be franchise mark is only associated with a small portion of the overall business. *See id.* Fractional franchises would include, for instance, a vehicle repair shop that performs oil changes as a limited portion of its business under a licensor's trademark, or an ice

and operates multiple franchise concepts under separate trademarks, each one would be considered a separate franchise system and would be treated independently for purposes of the franchisor's compliance with statutory requirements.<sup>188</sup>

### 3. Franchise Fee

FIPA defines a "franchise fee" as a direct or indirect payment for the right to enter into or continue a business under a franchise agreement.<sup>189</sup> A "franchise fee" may be a lump sum payment, royalties or other payments based on sales, a payment for the mandatory purchase of goods or services only available from the franchisor, a training fee, or training school fees.<sup>190</sup> However, the definition excludes certain types of transactions, including the purchase of goods at a bona fide wholesale price, a bona fide loan, and the purchase or lease of property or fixtures at fair market value.<sup>191</sup>

A franchise fee need not be named as such to meet the statute's definition, and initially, Washington courts had little difficulty finding "hidden" franchise fees. For example, where gasoline dealers leased premises from an oil company under a percentage rent lease,<sup>192</sup> the court of appeals upheld a ruling that the rental payments were franchise fees because the rent in fact paid by the dealer *could have* exceeded the fair rental value of the property.<sup>193</sup> Similarly, where an oil refiner coerced

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cream shop that sells another company's brand of frozen yogurt. These likely would fall outside Washington's definition of "franchise," because the association of the business with the other party's mark would not be "substantial." This is consistent with other courts' interpretations of the "substantial association" requirement under other states' franchise statutes. See, e.g., *Jerome-Duncan, Inc. v. Auto-By-Tel, L.L.C.*, 176 F.3d 904, 910-12 (6th Cir. 1999); *Hoosier Penn Oil Co. v. Ashland Oil Co.*, 934 F.2d 882, 885-86 (7th Cir. 1991); *Contractors Home Appliance, Inc. v. Clarke Distrib. Corp.*, 196 F. Supp. 2d 174, 178-79 (D. Conn. 2002); *Rudel Mach. Co. v. Giddings & Lewis, Inc.*, 68 F. Supp. 2d 118, 123-24 (D. Conn. 1999); *Sorisio v. Lenox, Inc.*, 701 F. Supp. 950, 961 (D. Conn. 1988). These courts have generally held that the business attributable to the alleged franchisee must represent a significant portion of the putative franchisee's overall business to meet the "substantial association" element of the franchise definition, because the very purpose of state franchise regulation is to protect a business that is dependent upon its franchisor.

188. *Madison House, Ltd. v. Sotheby's Int'l Realty Affiliates*, Bus. Franchise Guide (CCH) ¶ 13,591 (W.D. Wash. Feb. 20, 2007) (holding that where franchisee paid for the right to operate real estate brokerage business under "Sotheby's International Realty Affiliates," the franchisor's unrelated hotel, car rental, and other real estate franchise systems are not implicated). This becomes relevant, at least with respect to discrimination claims by franchisees alleging that the franchisor treated more favorably other franchisees operating under other trademarks. As the *Madison House* court held, "[c]reating uniform rate structures among these unrelated enterprises would not make sense." *Id.*

189. WASH. REV. CODE § 19.100.010(12) (2008).

190. *Id.*

191. *Id.*

192. That is, the rent was based on the dealer's sales volume.

193. *Corp v. Atlantic Richfield Co.*, 45 Wash. App. 563, 567-68, 726 P.2d 66 (1986).

dealers through an unlawful tying arrangement to buy tires, batteries, and accessories, the court held that the mandatory purchase of those products constituted the payment of a franchise fee because, as a result of the illegal tying agreement, the refiner was by definition charging more than a bona fide wholesale price.<sup>194</sup>

More recently, however, Washington courts have been more likely to evaluate the nature and purpose of the fee to determine whether it meets the statutory definition. In so doing, the courts have recognized that all commercial transactions involve payments from one party to another, but not all payments by a putative franchisee are franchise fees. While FIPA's definition of "franchisee fee" encompasses fees that a franchisor attempts to hide or disguise as some other type of payment, courts have made clear that a "franchisee fee" must have at least the following characteristics: the fee must represent an unrecoverable capital investment by the franchisee in the franchisor;<sup>195</sup> the fee must be paid to the franchisor or an affiliate, not to a third party;<sup>196</sup> the fee must be for the right to conduct the business; fees that are an ordinary business expense of a type and amount that typically would be incurred by anyone engaged in the type of business are not franchisee fees;<sup>197</sup> the fee paid must be mandatory, and not for optional goods or services;<sup>198</sup> and fees paid for goods or inventory must be more than "a bona fide wholesale price" or "fair market value."<sup>199</sup>

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194. *Blanton v. Mobil Oil Corp.*, 721 F.2d 1207, 1220 (9th Cir. 1983), *cert. denied*, 471 U.S. 1007 (1985) (citing *Chisum*, *supra* note 1, at 343) ("It is irrelevant that a forced overcharge is not specifically denominated a franchise fee [because] FIPA is intended to reach 'franchisors who might attempt to extract a hidden fee in the form of overcharges for property sold to the franchisee.'").

195. *Atchley v. Pepperidge Farm, Inc.*, No. CV-04-452-FVS, 2005 WL 1213959 (E.D. Wash. May 20, 2005); *Jon K. Morrison, Inc. v. Avis Rent-A-Car Sys., Inc.*, Bus. Franchise Guide (CCH) ¶ 12,701 (W.D. Wash. Nov. 20, 2003); *Corporate Res., Inc. v. Eagle Hardware & Garden, Inc.*, 115 Wash. App. 343, 350, 62 P.3d 544 (2003); *cf.* *Lobdell v. Sugar 'N Spice, Inc.*, 33 Wash. App. 881, 888, 658 P.2d 1267 (1983) (noting that primary purpose of FIPA legislation was to protect franchisees from losing money invested in a franchise as a result of having a lack of material information before purchasing and a lack of bargaining power after purchasing).

196. Indeed, even a payment made to the alleged franchisor is not a franchise fee if the franchisor (or affiliate) is not the beneficiary of the fee. *See Bryant Corp. v. Outboard Marine Corp.*, Bus. Franchise Guide (CCH) ¶ 10,604 (W.D. Wash. Sept. 29, 1994), *aff'd*, 77 F.3d 488 (9th Cir. 1996); *Atchley*, 2005 WL 1213959.

197. *Bryant Corp.*, Bus. Franchise Guide (CCH) ¶ 10,604; *Jon K. Morrison, Inc.*, Bus. Franchise Guide (CCH) ¶ 12,701; *Atchley v. Pepperidge Farm, Inc.*, Bus. Franchise Guide (CCH) ¶ 13,338 (E.D. Wash. Mar. 20, 2005), *reconsideration denied*, Bus. Franchise Guide (CCH) ¶ 13,437 (E.D. Wash. Sept. 7, 2006).

198. *Atchley*, Bus. Franchise Guide (CCH) ¶ 13,338.

199. WASH. REV. CODE § 19.100.010(12)(a), (e) (2008). A bona fide wholesale price is any price less than the retail price. *Bryant Corp.*, Bus. Franchise Guide (CCH) ¶ 10,604.

### B. Registration

In Washington, franchising is regulated by the Department of Financial Institutions through its Securities Division.<sup>200</sup> Washington requires franchisors to register their franchise offerings prior to making any offer or sale to a prospective franchisee, unless that franchise offering is subject to a statutory exemption.<sup>201</sup> Washington follows the format and content requirements established by NASAA.<sup>202</sup>

The registration application must include the following: the franchisor's FDD; the standard form franchise agreement and any other agreements that franchisees would be required to enter into with the franchisor or its affiliates; the franchisor's audited financial statements and the independent auditor's consent to use those financial statements for the purposes of evaluating the offering; disclosure forms for each person involved in franchise sales on behalf of the franchisor; a consent to service of process in Washington; a verification by a corporate officer of the accuracy of the information in the application and disclosure document; a "supplemental information" page with additional disclosures about the franchise system; and a state-specific addendum identifying any Washington-specific revisions or amendments to the disclosure document and franchise agreements.<sup>203</sup> If the franchisor is filing a renewal application of a previous franchise registration, then the franchisor must file a second copy of the disclosure document and its attachments showing, in redline form, the revisions from the prior filing.<sup>204</sup>

In 2007, the FTC introduced a new mandatory form of the FDD.<sup>205</sup> NASAA adopted the FTC format with few additional requirements, and all states that require registration, including Washington, now allow franchisors to use the FTC format.<sup>206</sup>

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200. WASH. REV. CODE § 19.100.010(3); *id.* § 19.100.040.

201. *Id.* § 19.100.020(1).

202. WASH. ADMIN. CODE 460-80-315 (2007).

203. *Id.* 460-80-125.

204. *Id.*

205. Under the prior system, franchisors had the option to use the FTC format or the format prescribed by NASAA. *See, e.g.*, [http://www.nasaa.org/About\\_NASAA/](http://www.nasaa.org/About_NASAA/).

206. The states that require advance registration of franchise offerings are California, Hawaii, Illinois, Indiana, Maryland, Minnesota, New York, North Dakota, Rhode Island, South Dakota, Virginia, Washington, and Wisconsin. Michigan requires franchisors to file a notice of their intent to sell franchises, but does not require franchisors to file the offering documents. Both the FTC and NASAA have propounded guidelines for complying with the disclosure requirements. *See* FED. TRADE COMM'N, FRANCHISE RULE COMPLIANCE GUIDE (2008) [hereinafter *FTC GUIDELINES*]; NASAA GUIDELINES, *supra* note 137.

The FDD itself has three parts: the cover pages, the substantive disclosure information, and the receipt page. There are two cover pages:<sup>207</sup> one is required by the FTC<sup>208</sup> and the other by NASAA.<sup>209</sup> The substantive portion of the FDD is divided into twenty-three separate subjects, or “Items.”<sup>210</sup> The Items provide the franchisee with substantive information about the franchised business.<sup>211</sup> The third element of the FDD is the receipt page, which confirms that the franchisee has received the disclosure document and all of its attachments.<sup>212</sup> The receipt page also documents the timing of the franchisee’s receipt of the disclosure document and starts the clock on the mandatory waiting period before any franchise agreement can be executed.<sup>213</sup>

Under NASAA guidelines, a franchisor’s financial statements must show the franchisor’s year-end balance sheet in each of the last two fiscal years, as well as the franchisor’s statements of operations, equity, and cash flows for each of the last three fiscal years.<sup>214</sup> Also, except in “extraordinary cases,” those financial statements must be audited by an

207. Both cover pages are designed to deliver specific cautions and warnings to the prospective franchisee about the system, including statements that no governmental authority has verified the information in the disclosure document; warnings about the application of other states’ laws to the franchise relationship; the cost of any required out-of-state mediation, arbitration, or litigation; and any system-specific warnings that the state deems necessary. In the authors’ experience, Washington rarely requires any franchise-specific warnings, which are more common in California, Illinois, and Maryland, among others. The cover pages also identify the primary trademarks that the franchised business will operate under, the general nature of the franchised business, the estimated start-up costs of the business, and the initial fee that the franchisee must pay to the franchisor. See discussion *infra* Part IV.C for additional information about the franchise disclosure document.

208. 16 C.F.R. § 436.3 (2008).

209. NASAA GUIDELINES, *supra* note 137, at 3.

210. 16 C.F.R. § 436.5 (2008). The specific “Items” that the franchisor must include in the franchise disclosure document are: (1) The Franchisor and any Parents, Predecessors, and Affiliates; (2) Business Experience; (3) Litigation; (4) Bankruptcy; (5) Initial Fees; (6) Other Fees; (7) Estimated Initial Investment; (8) Restrictions on Sources of Products and Services; (9) Franchisee’s Obligations; (10) Financing; (11) Franchisor’s Assistance, Advertising, Computer Systems, and Training; (12) Territory; (13) Trademarks; (14) Patents, Copyrights, and Proprietary Information; (15) Obligation to Participate in the Actual Operation of the Franchise Business; (16) Restrictions on What the Franchisee May Sell; (17) Renewal, Termination, Transfer, and Dispute Resolution; (18) Public Figures; (19) Financial Performance Representations; (20) Outlets and Franchisee Information; (21) Financial Statements; (22) Contracts; and (23) Receipts. *Id.*

211. Disclosure items include substantive issues about the franchisor and its personnel and litigation; the fees and costs associated with the franchised business; restrictions and requirements on operating the business; rights and limitations relating to the franchisor’s trademarks, copyrights, and patents; key provisions of the franchise agreement; the financial performance of other franchisees and the franchisor’s own outlets; and the number, locations, and identities of other franchisees, including details on the addition and termination of other franchisees. See discussion *infra* Part IV.C for additional information about the franchise disclosure document.

212. 16 C.F.R. § 436.5 (2008).

213. See discussion *infra* Part IV.C for additional information about timing requirements.

214. NASAA GUIDELINES, *supra* note 137, at 66.

independent accountant.<sup>215</sup> For franchisors whose financial statements are unaudited, or when the financial statements raise “going concern” warnings or otherwise indicate faltering performance, the state is empowered to require that the franchisor establish an escrow account to hold initial franchise fees until the franchisee is open for business.<sup>216</sup> That helps ensure that the franchisor will still be solvent and operational when the franchisee is in a position to begin generating revenue.

Franchisors also are obligated to pay fees for registration and renewal of their franchise offerings.<sup>217</sup> Registrations are valid for one year from the date of issue.<sup>218</sup> The state retains the authority to issue a stop order suspending the effectiveness of any registration if it determines that the registration documents contain any false or misleading representations, that the franchisor has violated franchise regulations, that the franchise offering has become subject to a federal injunction or an injunction of another state, that the franchisor’s enterprise or business methods are illegal, or that the franchise offering would defraud purchasers.<sup>219</sup>

Franchisors must update their disclosure documents with the annual renewal filing, but must also update the documents and file an amended registration if there is any “material adverse change” in the franchisor’s condition or any “material change” in the information contained in the disclosure document.<sup>220</sup> The franchisor must file the amended registra-

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215. WASH. ADMIN. CODE 460-80-140 (2007). This requirement is facially at odds with the NASAA guidelines’ explicit authorization for franchisors to use unaudited or only partly audited financial statements in a franchisor’s first or second full fiscal year selling franchises. See NASAA GUIDELINES, *supra* notes 137, at 66. In the authors’ experience, Washington has interpreted its own “extraordinary cases” language broadly to include a franchisor’s early years and has accepted unaudited or partially audited financial statements for those periods.

216. See WASH. REV. CODE § 19.100.050 (2008); WASH. ADMIN. CODE 460-80-140 (2007). Also, although not explicitly provided for under Washington law, the Department has interpreted its regulatory mandate to allow for franchisors to post a surety bond to provide that same security against the franchisor’s bankruptcy or insolvency. See SEC. DIV., WASH. DEP’T OF FIN. INSTS., RE: RCW 19.100.050, SURETY BONDS IN LIEU OF AN IMPOUND, FRANCHISE ACT POLICY STATEMENT, FPS-03 (Jan. 1, 1991). The state also generally allows franchisors to defer the payment of initial franchise fees from franchisees in lieu of escrow or bond.

217. WASH. REV. CODE § 19.100.240 (2008). As of the publication of this Article, the fee for an initial franchise registration is \$600; the fee for either renewing or amending a registration is \$100. *Id.*

218. *Id.* § 19.100.070(1). For renewals, Washington follows an anniversary date system; in other words, even if the renewal is approved earlier, it will not become effective until the anniversary of the prior year’s effective date of registration. When a franchisor files a renewal application well in advance of the expiration date, this can generate confusion by having an approval for the following year’s offering (which will have material changes and updates from the prior disclosure document) without being able to use it until its effective date.

219. *Id.* § 19.100.120.

220. *Id.* § 19.100.070(3). The statute does not define or describe what rises to the level of a “material” change. Under the FTC’s guidelines relating to quarterly updates, it gives as examples of

tion “as soon as reasonably possible and in any case, before the further sale of any franchise.”<sup>221</sup> The FTC rule requires franchisors to update their disclosures at least quarterly.<sup>222</sup> Washington has not yet adopted the FTC rule’s explicit timing requirement for registering updated disclosure documents.

Certain franchisors are exempt from the state’s registration requirements.<sup>223</sup> One exemption applies to large, well-developed franchisors. Those are defined as any franchisor that has a consolidated net worth of at least \$5 million (or at least \$1 million when the a parent company is worth at least \$5 million); that has had at least twenty-five franchisees in business at all times during the prior five years; and that requires an initial investment by the franchisee of more than \$100,000.<sup>224</sup> On the other end of the spectrum, the state also exempts from registration very small franchise operations. Small franchisors are those that do not have franchises outside the state, that do not have more than three total franchised businesses in the state, and that do not advertise or generally solicit purchasers for the franchise offering.<sup>225</sup> Although both the very large and very small franchisors are exempt from registration, they are still required to make the same set of disclosures to franchisees as required of all other franchisors.<sup>226</sup>

Other franchise sales are exempted from both registration and disclosure requirements. Those include: sales by a franchisee of its own franchise,<sup>227</sup> sales by an executor, receiver, bankruptcy trustee, or guardian,<sup>228</sup> sales by a bank, trust company, insurance company, investment company, or pension to a purchaser acting for itself or in a fiduciary

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material changes “the recent filing of a bankruptcy petition or the filing against the franchisor of a legal action that may have a negative effect on its financial condition.” FTC GUIDELINES, *supra* note 206, at 126. Those examples are not exclusive, nor do they control Washington’s interpretation of its statute, but the state would likely find those persuasive indicators that a change is not “material” unless it is both significant and adverse to the franchisor or the franchise system.

221. WASH. REV. CODE § 19.100.070(3).

222. 16 C.F.R. § 436.7(b) (2008).

223. *See* WASH. REV. CODE § 19.100.030.

224. *Id.* § 19.100.030(4)(b)(i).

225. *Id.* § 19.100.030(4)(b)(ii). This small franchisor exemption allows a successful operator to license the right to operate the same business to a family member, store manager, or other insider without the time or expense required to register. *See also* Dale v. Black, 81 Wash. App. 599, 601–02, 915 P.2d 1116 (1996) (confirming entitlement to isolated transaction exemption); Morris v. Int’l Yogurt Co., 41 Wash. App. 226, 230, 703 P.2d 318 (1985), *rev’d in part on other grounds*, 107 Wash. 2d 314, 729 P.2d 33 (1986) (holding that franchise sale prior to circulation of advertisement was still entitled to isolated transaction exemption).

226. WASH. REV. CODE § 19.100.030(4)(a). *See* discussion *infra* Part IV.C for additional information about disclosure requirements.

227. WASH. REV. CODE § 19.100.030(1).

228. *Id.* § 19.100.030(2).

capacity,<sup>229</sup> sales to an “accredited investor,”<sup>230</sup> and sales by a franchisor to existing franchisees when the franchise offering is substantially the same as the existing franchise.<sup>231</sup> Although not explicitly covered by statute or regulation, Washington state has taken the position that it will not enforce its registration or disclosure requirements against franchisors who advertise franchise offerings over the Internet, so long as those franchisors do not sell franchises in Washington, do not direct offers to individuals in Washington, and indicate in any advertisements that the franchises are not being offered to Washington residents.<sup>232</sup>

When a franchisor claims to be exempt from registration, the franchisor bears the burden of proof to establish its entitlement to that exemption.<sup>233</sup> Even if a franchisor qualifies for an exemption, the state is empowered to deny, suspend, or revoke that exemption if: the franchisor violates any provision under FIPA; the franchise offering becomes subject to a federal injunction or an injunction of another state; the franchisor’s enterprise or business methods are illegal; or the franchisor has defrauded purchasers.<sup>234</sup> FIPA makes it unlawful to make any untrue statement of material fact or willfully to omit any required material fact in any franchise application, notice, or report filed with the state.<sup>235</sup>

Subfranchisors are subject to the same registration requirements and exemptions that apply to franchisors.<sup>236</sup> A “subfranchisor” is anyone who is given the right to grant, sell, or negotiate the sale of franchises.<sup>237</sup>

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229. *Id.* § 19.100.030(3).

230. *Id.* § 19.100.030(5). The state’s definition of “accredited investor” appears in section 460-80-108 of the Washington Administrative Code.

231. *Id.* § 19.100.030(6). In other words, entering into a new franchise agreement with an existing franchisee, so long as the franchised business is substantially the same as before and the franchise agreement has not fundamentally changed. This is the only instance in which a franchisor’s sale of a franchise offering is not subject to the state’s disclosure requirements.

232. See SEC. DIV., WASH. DEP’T OF FIN. INSTS., RE: FRANCHISE OFFERINGS ON THE INTERNET, 7 FRANCHISE ACT POLICY STATEMENT FPS-07 (Aug. 18, 1999).

233. WASH. REV. CODE § 19.100.220. This burden applies generally to any person who asserts entitlement to any exception from a statutory definition under FIPA. The Washington Supreme Court has held that exemptions from franchise registration must be strictly construed. *Morris v. Int’l Yogurt Co.*, 107 Wash. 2d 314, 319, 729 P.2d 33 (1986).

234. WASH. REV. CODE § 19.100.255.

235. *Id.* § 19.100.170(1).

236. At least arguably, the Securities Division extends the definition of “subfranchisor” beyond FIPA’s intent or text, requiring dual registration by both the franchisor and subfranchisor. See SEC. DIV., WASH. DEP’T OF FIN. INSTS., RE: SUBFRANCHISOR REGISTRATION REQUIREMENTS, 1 FRANCHISE ACT INTERPRETIVE STATEMENT FIS-01 (Jan. 1, 1991) [hereinafter FIS-1]. The Washington Court of Appeals, in an unpublished opinion, has questioned the Securities Division’s dual registration Interpretive Opinion. See *O.P.E.N. America, Inc. v. Phnouk*, Bus. Franchise Guide (CCH) ¶ 10,675 (Wash. Ct. App. 1995) (holding that FIPA does not appear to require dual registration, despite the Securities Division’s policy to require both franchisor and subfranchisor to register separately).

237. WASH. REV. CODE § 19.100.010(9), (10).

This has generally been interpreted as someone acting independently from the franchisor to negotiate and sell franchises within the state, and not as an agent or employee of the franchisor who is under the franchisor's control.<sup>238</sup> In general, subfranchisors enter into an agreement with a franchisor to sell franchises directly to prospects within a certain state or territory using the "parent" franchisor's trademarks and system.<sup>239</sup> Subfranchisors are subject to the same registration and disclosure requirements because they are standing in the shoes of the franchisor and placing the franchisee at the same risk as in a conventional two-tier franchise system.<sup>240</sup>

The state also requires franchise brokers to obtain a franchise broker license.<sup>241</sup> A "franchise broker" is "a person who directly or indirectly engages in the business of the offer or sale of franchises"; however, this definition does not include officers, directors, or employees of franchisors and subfranchisors.<sup>242</sup> Franchise brokers typically work as independent contractors or sales agents, developing leads and generating prospects for franchise companies in exchange for a fee or a commission if a franchise is sold.<sup>243</sup> Unlike subfranchisors, franchise brokers are not a party to any franchise agreement ultimately signed. The franchise broker license application primarily seeks background information on the broker (whether a person or an entity) and whether the broker has previously been found to have violated any laws or regulations relating to franchising.<sup>244</sup> That application is subject to change by the Department of Financial Institutions.<sup>245</sup>

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238. See FIS-1, *supra* note 236. See also *Johnson v. Mail Boxes Etc., USA, Inc.*, Bus. Franchise Guide (CCH) ¶ 11,803 (Wash. Ct. App. 2000) (holding that an "Area Franchisee," who was responsible for providing local support for franchisees, received payment from the franchisor based on franchisees' royalties, and helped locate and solicit franchisees in the Area Franchisee's territory was not a "subfranchisor" under FIPA because the Area Franchisee was not authorized to enter into, sell, grant, or alter any franchises with individual franchisees).

239. See Ann Hurwitz, *Co-Branding: Managing Franchise Brand Ass 'ns*, 20 OKLA. CITY U. L. REV. 373, 386-87 (1995).

240. *Cf. id.*

241. WASH. REV. CODE § 19.100.140.

242. *Id.* § 19.100.010(11).

243. See Hurwitz, *supra* note 239, at 387.

244. See Application for Franchise Broker License, available at <http://www.dfi.wa.gov/sd/franchiseformsapps/fba.pdf> (last visited April 26, 2009).

245. See discussion *supra* Part III.C.5 for additional information about registration requirements for franchisor advertisements. Franchisors are prohibited from including any false or misleading representations in their advertisements, and the state is empowered to enforce the use of any advertisements that violate that prohibition. WASH. REV. CODE § 19.100.110.

### C. Disclosure and Sale

Once the state has approved a franchisor's registration, or if the franchisor is exempt from registration and files an exemption notice,<sup>246</sup> the franchisor is allowed to begin offering and selling its franchises in Washington.

An "offer" of a franchise is subject to Washington's registration and disclosure laws whenever:

- (a) The offer is directed by the offeror into this state from within or outside this state and is received where it is directed, (b) the offer originates from this state and violates the franchise or business opportunity law of the state or foreign jurisdiction into which it is directed, (c) the offeree is a resident of this state, or (d) the franchise business that is the subject of the offer is to be located or operated, wholly or partly, in this state.<sup>247</sup>

A "sale" of a franchise is subject to Washington law whenever:

- (a) An offer to sell is accepted in this state, (b) an offer originating from this state is accepted and violates the franchise or business opportunity law of the state or foreign jurisdiction in which it is accepted, (c) the purchaser of the franchise is a resident of this state, or (d) the franchise business that is the subject of the sale is to be located or operated, wholly or partly, in this state.<sup>248</sup>

Before the franchisor and any new franchisee enter into any binding agreement, and before the franchisor receives any consideration from the franchisee, the franchisor must provide its FDD and attachments to the prospective franchisee.<sup>249</sup> Under the FTC rule, fourteen calendar days must pass between the franchisor's disclosure to the prospective franchisee and the execution of any binding agreement or any payment by the franchisee to the franchisor.<sup>250</sup> Under current Washington law, that period is instead ten "business days."<sup>251</sup> Upon receiving the disclosure

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246. WASH. REV. CODE § 19.100.070(1).

247. *Id.* § 19.100.020(2). The statute specifically excepts from its coverage an offer that "appears: (a) In a newspaper or other publication of general and regular circulation if the publication has had more than two-thirds of its circulation outside this state during the twelve months before the offer is published, or (b) in a broadcast or transmission originating outside this state." *Id.* § 19.100.020(4).

248. *Id.* § 19.100.020(3).

249. *Id.* § 19.100.080.

250. 16 C.F.R. § 436.2(a) (2008).

251. WASH. REV. CODE § 19.100.080. It is likely that the Washington statute eventually will be revised to conform to the federal fourteen calendar day standard.

document, franchisees are required to execute a receipt confirming that they have received the disclosure document and all of its attachments.<sup>252</sup>

It is unlawful, in connection with any offer, sale, or purchase of a franchise or subfranchise: (a) to make any untrue statement of material fact in any written or oral communication; (b) to omit any material fact “necessary in order to make the statements made in light of the circumstances under which they were made not misleading”; (c) to employ any device, scheme, or artifice to defraud; (d) to engage in any act, practice, or course of business that operates or would operate as a fraud or deceit upon any person; or (e) to violate any order of the director of the Securities Division.<sup>253</sup>

The contracts included with the FDD represent the standard franchise agreement that the franchisor is willing to enter into with a prospective franchisee.<sup>254</sup> In practice, the agreement form disclosed and the actual agreement entered into may vary considerably. Under the FTC rule, if the franchisor unilaterally and materially alters the terms of the franchise agreement prior to execution, then the franchisor must give the revised agreement to the franchisee at least seven calendar days before the franchisee signs.<sup>255</sup> If the franchisee initiates negotiations, no waiting period (other than the fourteen calendar days after initial disclosure) is required.<sup>256</sup>

Washington law does not impose any waiting periods relating to changes in the standard form agreement. But FIPA does state that negotiations initiated by the franchisee will not violate the statute, as long as the ultimate terms of the agreement are not unlawful.<sup>257</sup> This clarification is, at least in part, an explicit exception to FIPA’s anti-discrimination provision, which otherwise limits the franchisor’s ability to charge different franchisees different rates for royalties, goods, services, or other business dealings between franchisor and franchisee.<sup>258</sup>

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252. WASH. ADMIN. CODE 460-80-300 (2007). The FTC rule prescribes a different form of receipt than the one currently appearing in section 460-80-300 of the Washington Administrative Code. 16 C.F.R. § 436.5(w) (2008). NASAA’s adoption of the FTC format on behalf of its member states (which includes Washington) has rendered questionable the continuing effect of the format portion of this section of the Administrative Code. NASAA GUIDELINES, *supra* note 137, at 1.

253. WASH. REV. CODE § 19.100.170. In this respect, sales of franchises are subject to a standard very similar to the sale of securities. *See, e.g.*, Washington Securities Act, WASH. REV. CODE § 21.20.010.

254. The franchisor need only disclose the terms of the *current* franchise agreement, but not the terms of any future agreement, even where a future agreement is contemplated by the first agreement. *Thompson v. Atlantic Richfield Co.*, 649 F. Supp. 969, 973 (W.D. Wash. 1986).

255. 16 C.F.R. § 436.2(b) (2008).

256. *Id.*

257. WASH. REV. CODE § 19.100.184.

258. *Id.* § 19.100.180(2)(c). *See* discussion *infra* Part V.D.2.c for additional information about FIPA’s anti-discrimination provision.

Most FDDs are accompanied by a set of state-specific addenda to the agreements and the disclosure contents. This format allows multi-state franchisors to use a single disclosure document and contract form, and to excerpt any revisions required by individual states' laws into a separate addendum. Washington is one of the few states that currently provides a sample addendum that captures the revisions that the state contends are necessary to the typical FDD and franchise agreement.<sup>259</sup> That sample addendum specifies that (1) FIPA's "Franchisee Bill of Rights"<sup>260</sup> provisions and court decisions may supersede sections in the franchise agreement; (2) arbitrations required under the franchise agreement must take place in Washington, at a site agreed upon at the time of the arbitration, or at a location determined by the arbitrator; (3) FIPA prevails if there is any conflict of laws; (4) releases or waivers cannot release FIPA rights except pursuant to a negotiated settlement where the parties are represented by independent counsel; (5) contract provisions that limit statutory limitations periods or waive jury rights may not be enforceable; and (6) transfer fees must be limited to an amount reflecting the franchisor's reasonable costs of effecting a transfer.<sup>261</sup>

As discussed in more detail below, each of these provisions in the state's sample addendum has dubious legal authority and scant practical basis for requiring them to be incorporated into the FDD or franchise agreement.

### 1. Franchisee Bill of Rights

There is little question that the legislature, through the Franchisee Bill of Rights, and Washington courts, through common law precedent, generally have the authority to trump contradictory contract terms in

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259. Washington's sample addendum arises in part out of a Policy Statement issued by the Securities Division, which contains the Division's position on how franchisors should disclose FIPA's prescribed rights and prohibitions to prospective franchisees. See SEC. DIV., WASH. DEP'T OF FIN. INSTS., RE: FRANCHISEE – FRANCHISOR RELATIONSHIP DISCLOSURE REQUIREMENTS, RCW 19.100.180, 1 FRANCHISE ACT POLICY STATEMENT FPS-01 (Jan. 1, 1991).

260. The "Franchisee Bill of Rights" is shorthand for the franchise regulatory provisions codified at section 19.100.180(2) of the Revised Code of Washington. See *East Wind Express, Inc. v. Airborne Freight Corp.*, 95 Wash. App. 98, 102, 974 P.2d 369, 372 (1999) (identifying FIPA's relationship provisions as the "Franchisee Bill of Rights"). Specifically, the statute regulates the franchise relationship by imposing a series of required and prohibited standards of conduct, most of which are directed at the franchisor. The Bill of Rights was intended to ameliorate the perceived imbalance in bargaining power between franchisor and franchisee that leads to non-negotiable terms in the franchise relationship. *Id.* at 103 (citing Chisum, *supra* note 1, at 296–97). For that reason, this type of statute is often referred to as a "franchise relationship statute."

261. The State's sample addendum is currently available on the DFI website. Sample Washington Franchise Agreement Addendum, <http://www.dfi.wa.gov/sd/franchiseformsapps/sampleadd.pdf> (last visited April 26, 2009) [hereinafter Sample Addendum].

franchise agreements. There is no apparent utility in requiring disclosure of that fact except to the most unsophisticated franchisee prospects.

## 2. Arbitration Situs

The Securities Division's official policy position on arbitration, prohibiting out-of-state venue selection, is based on the agency's interpretation of (1) the Bill of Rights' requirement that the parties deal with each other in good faith; and (2) the Bill of Rights' determination that it is an unfair act or practice for a franchisor to impose an unreasonable standard of conduct on the franchisee.<sup>262</sup> Based on the perceived "greater bargaining power" of the franchisor, the Division makes the broad leap to the conclusion that any contract provision that prospectively requires out-of-state arbitration is not in good faith, reasonable, or a fair act or practice. This tenuous conclusion seems particularly unsupportable in light of the Division's official acknowledgement that "[r]ecent court cases demonstrate that an agreement to arbitrate preempts judicial action which might be taken under the Franchise Investment Protection Act of Washington."<sup>263</sup> Moreover, the Division neither acknowledges nor con-

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262. See SEC. DIV., WASH. DEP'T OF FIN. INSTS., RE: ARBITRATION SITE, RW 19.100.180(1), 4 FRANCHISE ACT INTERPRETIVE STATEMENT FIS-04 (Jan. 1, 1991) [hereinafter FIS-4]. Although section 19.100.250 of the Revised Code of Washington explicitly grants the Division the discretion to "honor requests from interested persons for interpretive opinions" on FIPA provisions, Washington's Administrative Procedure Act is clear that any such "interpretive and policy statements are advisory only," and agencies are "encouraged to convert long-standing interpretive and policy statements into rules." WASH. REV. CODE § 34.05.230(2) (2008). Rulemaking requires agencies to follow certain formal (and potentially lengthy) procedures. See generally WASH. REV. CODE § 34.05.320 (identifying statutory procedure for agencies to initiate rulemaking proceedings). To date, the Division has not sought to codify any of its interpretive opinions or policy statements into formal rules. Nevertheless, in the authors' experience, the Division has occasionally cited those interpretive opinions or policy statements as the basis to deny or condition approval of a franchise registration. That denial or conditioning would violate the applicant's due process rights because those opinions and statements do not have any legal effect and are nothing more than the Division's interpretation of FIPA's requirements and restrictions. See *Wash. Educ. Ass'n v. Wash. Pub. Disclosure Comm'n*, 150 Wash. 2d 612, 619, 80 P.3d 608 (2003) ("[T]he issuance of interpretive statements is not governed by formal adoption procedures. There is no need for formal procedures because such advisory statements have no legal or regulatory effect. A person cannot violate an interpretive statement, and conduct contrary to the agency's written opinion does not subject a person to penalty or administrative sanctions.").

263. See FIS-4, *supra* note 262. The Washington Supreme Court has already indicated that any state prohibition on matters related to arbitration in franchise contracts will likely be preempted by the federal act. See *Allison v. Medicab Int'l, Inc.*, 92 Wash. 2d 199, 204, 597 P.2d 380 (1979) (holding that the FAA trumps state law and compels parties to arbitrate if provided for in franchise agreement).

siders the role of the Federal Arbitration Act<sup>264</sup> or its effect on any state law prohibition or limitation on contractual arbitration provisions.<sup>265</sup>

### 3. Conflict of Laws

The statement on conflict of laws, under which FIPA would prevail over another state's laws in the event of a conflict, is at best unnecessary. FIPA already applies to any offer or sale that takes place "in this state,"<sup>266</sup> a term that is defined broadly to include any contract that is negotiated or executed in Washington, involves a Washington franchisee or franchisor, or that relates to a franchised business to be located in Washington.<sup>267</sup> It also renders void any contract provision intended to

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264. 9 U.S.C. §§ 1–16 (2006).

265. Addressing this disparity between the Division's interpretation of Washington law and the mandate of the Federal Arbitration Act, the Sixth Circuit has concluded that the parties' contractual venue selection superseded the Division's overly broad interpretation of FIPA's good faith requirements. *See* *Mgmt. Recruiters Int'l, Inc. v. Bloor*, 129 F.3d 851, 855 (6th Cir. 1997).

266. WASH. REV. CODE § 19.100.020(2) (2008). By defining when conduct occurs "in this state," the legislature set the outer limit for FIPA's territorial reach. Thus, FIPA does not apply, and a franchisor's actions are not unlawful, so long as they do not fall within the definition of conduct occurring "in this state." *Cf.* *Chisum*, *supra* note 1, at 337 (recommending that the pre-1991 version of FIPA, which did not contain a definition for the phrase "in this state," be amended to conform to California's Franchise Investment law because it "contains an adequate definition of the key phrase 'in this state' which carefully spells out the territorial coverage of the law . . .").

267. WASH. REV. CODE § 19.100.020(2). One question that has not been addressed by a Washington court is whether parties that have not engaged in conduct "in this state" may nonetheless contractually agree to apply FIPA. The Seventh Circuit addressed this exact situation in *Cromeens, Holloman, Sibert, Inc. v. AB Volvo*, 349 F.3d 376, 385 (2003). In that case, the plaintiffs were franchisee-dealers of Samsung products located in Texas, Maine, Montana, New York, and two Canadian provinces. *Id.* The franchise agreements contained a choice of law provision selecting Illinois law. *Id.* at 384–85. After Volvo, Samsung's successor in interest, terminated their dealer agreements, the franchisees sought to apply the Illinois Franchise Dealer Act (IDFA) to prohibit termination of the franchise agreements. *Id.* at 383. But the IDFA, by its own terms, applied only to franchises located within the state of Illinois. *Id.* at 385. The plaintiffs argued that the territorial limitation did not apply because, under the Restatement of Conflict of Laws, a choice of law provision only incorporates the "local law" of the chosen state, and excludes the chosen state's choice of law rules. *Id.*; *see also* RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 187(3) cmt. h (1989). The court rejected that argument, noting that a statute's territorial limitations are *not* choice of law rules. *Cromeens*, 349 F.3d at 385 ("The plain language of the Illinois law that the Samsung Dealers seek to apply excludes those same dealers from its coverage because they are located outside of Illinois."). The Seventh Circuit's holding followed several other circuit courts that have addressed the effect that a choice of law provision has on territorial limitations contained within statutory remedies. *See* *Highway Equip. Co. v. Caterpillar, Inc.*, 908 F.2d 60, 64 (6th Cir. 1990) (holding that Illinois Franchise Dealer Act did not apply to Ohio-based franchisee despite Illinois choice of law); *Peugeot Motors of Am., Inc. v. E. Auto Distribs., Inc.*, 892 F.2d 355, 358 (4th Cir. 1990) (holding that New York Franchise Motor Vehicle Act did not apply to non-New York distributor despite New York choice of law). *See also* *Generac Corp. v. Caterpillar, Inc.*, 172 F.3d 971, 973 (7th Cir. 1999) (refusing to apply Wisconsin Fair Dealership Law to a contract where none of the sales took place in Wisconsin); *JRT, Inc. v. TCBY Sys., Inc.*, 52 F.3d 734, 736 (8th Cir. 1995) (holding that non-Arkansas franchisee had no cause of action under Arkansas franchise statute notwithstanding parties choice of law provisions selecting Arkansas law); *Forbes v. Joint Medical Products Corp.*, 976 F.

waive the application of the statute.<sup>268</sup> Thus, any franchise agreement to which the sample addendum would attach and apply is already subject to FIPA, which will prevail in the event of a conflict of laws.<sup>269</sup>

#### 4. Waiver

The limitation on the franchisee's waiver of rights is already made explicit by statute,<sup>270</sup> so it is of little significance to include it as a required addendum to the franchise agreement.<sup>271</sup>

#### 5. Statute of Limitations

There is no apparent basis for the sample addendum's statement that "[p]rovisions such as those which unreasonably restrict or limit the statute of limitations period for claims under the Act, rights or remedies under the Act such as a right to a jury trial may not be enforceable."<sup>272</sup> In any event, FIPA provides neither a statute of limitations nor a right to jury trial, so it is unclear how a contract could take away or limit rights that the statute never grants.<sup>273</sup>

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Supp. 124, 126 (D. Conn. 1997) (holding that Connecticut choice of law provision did not alter Connecticut Franchise Act's territorial limitations against claims by non-Connecticut based franchisees); Diesel Injection Serv. Co. v. Jacobs Vehicle Equip. Co., Bus. Franchise Guide (CCH) ¶ 12,388 (Conn. Super. Ct. Apr. 16, 2002) (holding that terminated distributor was not entitled to protection under Connecticut's Franchise Act notwithstanding Connecticut choice of law provision because the Act applied only to franchisees with a place of business in Connecticut and the distributor was located out of state); Greensboro Ford, Inc. v. Ford Motor Co., 568 S.E.2d 758, 760 (Ga. Ct. App. 2002) (holding that Michigan choice of law provision did not allow Georgia dealer to invoke Michigan's automotive statute). The Restatement also does not consider a territorial restriction as a choice of law provision. See RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 80 cmt. b (1989) (stating that a court should disregard a choice of law provision if the law of the chosen state would not apply to the parties or the transaction on its face). Based on the weight of this foreign authority, it is unlikely that a franchisor and franchisee could contract around FIPA's territorial limitations.

268. WASH. REV. CODE § 19.100.220(2) (2008).

269. See also Rutter v. BX of Tri-Cities, Inc., 60 Wash. App. 743, 748, 806 P.2d 1266 (1991) (holding that FIPA applied in dispute between California franchisor and Washington franchisee, regardless of California choice of law provision in franchise agreement).

270. WASH. REV. CODE § 19.100.220(2).

271. See discussion *infra* Part V.D.2.g for additional information about FIPA's anti-waiver policy.

272. Sample Addendum, *supra* note 261. In addition to lacking statutory or regulatory authority, the quoted sentence is not even grammatically sensible.

273. See discussion *infra* Part V.B.3 for additional information about the statute of limitations for franchise transactions.

## 6. Transfer Fees<sup>274</sup>

The sample addendum's limitation on transfer fees is a product of another interpretive decision issued by the Division.<sup>275</sup> There is neither any legal basis nor any practical need to restrict the transfer fees charged by the franchisor.<sup>276</sup>

### *D. Federal and State Enforcement Powers*

The federal government regulates franchise disclosure obligations through the FTC under the Federal Trade Commission Act (FTCA).<sup>277</sup> The FTC has the authority to pursue remedies against non-exempt franchisors that fail to provide the prescribed mandatory disclosures.<sup>278</sup> Violation of those disclosure requirements can result in federal enforcement actions and in private actions under certain state laws.<sup>279</sup> The potential penalties and remedies under an FTC enforcement action include temporary, preliminary and permanent injunctive relief, rescission and reformation of contracts, restitution, damages, disgorgement of funds, appointment of a receiver, and other equitable relief, in addition to any other penalties available under any other state or federal law.<sup>280</sup>

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274. Most franchise agreements contain a transfer fee provision, which requires the franchisee to pay a specific fee to the franchisor in the event that the franchisee elects to transfer the franchise to a new franchisee. That transfer is typically subject to approval by the franchisor. Transfer fees help the franchisor offset the administrative costs of evaluating the experience and financial strength of the transferee and of aiding the transferee on operational matters in the initial period after transfer. Transfer fees also help offset any decline in royalties or other recurring fees that occurs during the transition period.

275. See SEC. DIV., WASH. DEP'T OF FIN. INSTS., RE: RESTRICTIONS ON TRANSFER OF FRANCHISES, 2 FRANCHISE ACT INTERPRETIVE STATEMENT FIS-02 (Jan. 1, 1991) [hereinafter FIS-2]. The state's interpretative statement notably fails to cite section 19.100.030(1) of the Revised Code of Washington, which provides that the franchisor's right "to approve or disapprove the [franchisee's sale of its franchise] shall be exercised in a reasonable manner." That provision, which appears in FIPA's exemption provision, has no clear effect on the franchisor's duties to a franchisee. The state would be authorized to prosecute a franchisor's violation of that provision, but the provision's appearance only in section 19.100.030 indicates that the legislature did not intend its violation to provide the basis for a direct cause of action by a franchisee or to constitute an unfair or deceptive act.

276. See discussion *infra* Part V.D.3.a for additional information about transfer fees.

277. 15 U.S.C. §§ 41-58 (2006).

278. 16 C.F.R. § 436.5 (2008); 15 U.S.C. §§ 57b(a)(1), 57b-1(c) (2006).

279. Under the Franchise Rule, it is an "unfair or deceptive act or practice" to violate the disclosure rules. 16 C.F.R. § 436.2 (2008). Although Courts have generally held that the FTCA does not create a private right of action for such unfair or deceptive acts, violations may be prosecuted under some state laws. See cases cited *supra* note 67. In states that require disclosure, including Washington, failure to meet disclosure obligations may also allow the state to prosecute that violation separately.

280. 15 U.S.C. §§ 53(b), 57b(b) (2006).

The FTC pursues to conclusion ten to twenty civil suits against violators each year.<sup>281</sup> These actions tend to involve franchisors who fail to provide any disclosure documents to prospective franchisees. In general, where the franchisor has provided a facially compliant disclosure document, the FTC will leave disputes over the adequacy of individual disclosures to be resolved through private actions by the aggrieved party, except where the central allegation concerns the Item 19 earnings claim (financial performance representation) in the disclosure document.<sup>282</sup>

Under Washington law, the Securities Division is authorized to conduct “public or private” investigations both within and outside the state, as it deems appropriate. Those investigations allow the state to determine whether registration should be granted, denied, revoked, or suspended, or to determine whether a person has violated or will violate FIPA or any related regulation.<sup>283</sup> The Securities Division is also empowered to subpoena witnesses and obtain production of documents during its investigations.<sup>284</sup>

The Securities Division may impose penalties for registration and disclosure violations, which run the gamut from serious to mild, and include criminal liability,<sup>285</sup> fines and other monetary penalties,<sup>286</sup> cease and desist orders that enjoin further violations,<sup>287</sup> or revocation of an existing registration.<sup>288</sup> The state is empowered to combine these penalties as it sees fit to address the severity of the violation.<sup>289</sup> In any court action brought by the state, the court is authorized to grant reasonable attorneys’ fees to the prevailing party.<sup>290</sup>

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281. Summaries of concluded cases are available, as of the publication of this Article, at <http://www.ftc.gov/bcp/franchise/caselist.shtm>.

282. See BUREAU OF CONSUMER PROTECTION, FEDERAL TRADE COMM’N, FRANCHISE AND BUSINESS OPPORTUNITY PROGRAM REVIEW, 1993-2000, 30-31 (2001) available at <http://www.ftc.gov/bcp/menus/resources/guidance/franchise.shtm>. For enforcement actions pursued from 1993-1999, the vast majority of investigations and cases filed were based on violations of business opportunity rules, rather than franchise rules. *Id.* at 33-34. Virtually all allegations in franchise cases were based on unsupported or false earnings claims or on the franchisor’s complete failure to provide a disclosure document. *Id.* at 35, 37-39.

283. WASH. REV. CODE § 19.100.242 (2008).

284. *Id.* § 19.100.245.

285. *Id.* § 19.100.210(6).

286. *Id.* § 19.100.210(2)-(3).

287. *Id.* §§ 19.100.210(1), .248.

288. *Id.* § 19.100.120.

289. *Id.* § 19.100.910 (provisions of FIPA are cumulative and nonexclusive).

290. *Id.* § 19.100.210(1).

## V. CIVIL CLAIMS

A. *Who May Sue and Who is Liable*

FIPA authorizes a private action against “any person who sells or offers to sell a franchise in violation of this chapter,” and subjects those persons to liability “to the franchisee or subfranchisor.”<sup>291</sup> Thus, on its face, the Act suggests only a right of action by a defrauded franchisee, not by a defrauded franchisor.<sup>292</sup> Also, by authorizing a private right of action only for injured franchisees and subfranchisors, FIPA precludes any suit by a corporate franchisee’s owners, officers, or guarantors, despite any indirect damages they may incur.<sup>293</sup>

FIPA defines a “person” subject to liability as any:

[N]atural person, corporation, partnership, trust, or other entity and in the case of an entity, it shall include any other entity which has a majority interest in such an entity or effectively controls such other entity as well as the individual officers, directors, and other persons in act of control of the activities of each such entity.<sup>294</sup>

Where liability exists, FIPA suggests that it may run to any control person that falls within the Act’s definition of a “person.”<sup>295</sup> If this is what the legislature intended, it is at best a convoluted manner of imposing control-person liability. Instead, one would expect a specific enumeration of who may constitute a control person, and under what circumstances such a person would be liable.

The statute also provides no guidance as to when a person is “in act of control of the activities” of a franchisor. It is therefore unclear whether a control person must be a corporate insider, or whether the definition includes an independent contractor, such as an accountant providing audited financial statements for the franchisor’s FDD, or the attorney who prepared the FDD. The definition of “person” also leaves unclear whether a control person is strictly liable for the corporate franchisor’s

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291. *Id.* § 19.100.190(2).

292. However, FIPA does have a separate provision that makes it unlawful to make any untrue statement or to omit any material fact in the “purchase” of a franchise or subfranchise. *Id.*; see also *id.* § 19.100.170 (2008). Despite the “unlawful” nature of that conduct, the legislature appears not to have intended any private right of action for an injured franchisor. Moreover, the franchisor alone is charged with complying with franchise registration requirements, and cannot assign fault to a franchisee who executes an agreement under an unregistered franchise offering. *GR8 Wheels, Inc. v. Morris, Bus. Franchise Guide (CCH) ¶ 13,770 (Wash. Super. Ct. Oct. 19, 2007).*

293. *Ward Enters., Inc. v. Bang & Olufsen Am.*, 2003 WL 22859793, *Bus. Franchise Guide (CCH) ¶ 12,735 (N.D. Ill. Dec. 2, 2003).*

294. WASH. REV. CODE § 19.100.010(13) (2008).

295. *Id.* § 19.100.190(2) (“Any person who sells or offers to sell a franchise . . . shall be liable to the franchisee . . .”).

violations, or whether the control person must be culpable in some sense. The definition of “person” uses the word “shall” with respect to imposing liability, which may suggest that any control person is strictly liable. However, in other contexts, Washington courts have made it clear that the word “shall,” when used in a statute, may be directory, not mandatory.<sup>296</sup> Read in this fashion, the statute would permit a determination of a control person’s liability, but liability would depend upon his or her knowledge or involvement in the wrongdoing. Indeed, it would seem unlikely that, when it declined to do so under the Securities Act, the legislature intended to impose strict liability upon a control person who has no knowledge or involvement with any wrongdoing under FIPA.<sup>297</sup>

### B. Civil Remedies

If a franchise is sold in violation of FIPA (such as when the franchise offering has not been registered) or in violation of FIPA’s antifraud

296. See *Spokane County ex rel. Sullivan v. Glover*, 2 Wash. 2d 162, 169, 97 P.2d 628 (1940). As a general rule, the word “shall,” when used in a statute, is imperative and operates to impose a duty which may be enforced, while the word “may” is permissive only and operates to confer discretion. These words, however, are frequently used interchangeably in statutes, and without regard to their literal meaning. In each case, the word is to be given that effect which is necessary to carry out the intention of the legislature as determined by the ordinary rules of construction.

*Id.* See also *State v. McDonald*, 89 Wash. 2d 256, 262–63, 571 P.2d 930 (1978); *City of Spokane v. Spokane Police Guild*, 87 Wash. 2d 457, 465, 553 P.2d 1316 (1976) (the word “shall” in a statute may be construed as directory rather than mandatory depending upon legislative intent); *Walters v. Hampton*, 14 Wash. App. 548, 551, 543 P.2d 648 (1975) (the word “shall” has been found to be permissive when used in certain statutes).

297. The Securities Act expressly provides for joint and several liability, but it allows a control person to avoid liability if he or she had no knowledge of the events giving rise to liability:

Every person who directly or indirectly controls a seller or buyer liable under subsection (1) or (2) above, every partner, officer, director . . . is also liable jointly and severally with and to the same extent as the seller or buyer, *unless such person sustains the burden of proof that he or she did not know, and in the exercise of reasonable care could not have known, of the existence of the facts by reason of which the liability is alleged to exist.*

WASH. REV. CODE § 21.20.430(3) (2008) (emphasis added). Like the Washington Securities Act, franchise statutes in other states often impose liability upon individual officers, directors, and controlling persons *based upon whether such persons had knowledge of or participated in the wrongful act*. For example, the New York statute, which is fairly typical of the franchise statutes of the various states, provides that a controlling person, officer, or director is jointly and severally liable with the corporation *if she* “materially aids in the act or transaction constituting the violation.” N.Y. GEN. BUS. LAW § 691(3) (McKinney 2008). The above “affirmative defense” is specifically set forth in the California statute, which uses joint and several liability language identical to that used in the civil liabilities section of the Washington Securities Act:

Every person who directly or indirectly controls a person liable under Section 31300 or 31301, . . . are also liable jointly and severally with and to the same extent as such person, *unless the other person who is so liable had no knowledge of or reasonable grounds to believe in the existence of the facts by reason of which the liability is alleged to exist.*

CAL. CORP. CODE § 31302 (West 2008) (emphasis added).

provisions, FIPA grants a private right of action to the franchisee, allowing it to either avoid the franchise and seek rescission, or to affirm the franchise and sue for damages.<sup>298</sup> FIPA also allows the court to increase an award of damages in those actions to an amount up to three times the actual damages incurred.<sup>299</sup> The prevailing party may also recover its reasonable attorneys' fees.<sup>300</sup>

### 1. Rescission

Rescission may be the only remedy practically available for a claim based on the franchisor's failure to register or for another technical violation of FIPA (i.e., a sale made in violation of FIPA, but not involving any misrepresentation actionable under FIPA's antifraud provisions).<sup>301</sup> A rescission claim under FIPA is subject to common law equitable defenses.<sup>302</sup> Thus, a plaintiff who seeks rescission based on violations of

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298. WASH. REV. CODE § 19.100.190(2). This election of remedies is consistent with the remedies available at common law for fraud. *See, e.g.,* Weitzman v. Bergstrom, 75 Wash. 2d 693, 697, 453 P.2d 860 (1969) (holding that a party to a contract obtained by fraud may seek to avoid the contract by electing to rescind, provided the party acts promptly, or it may affirm the contract and sue for damages). Section 19.100.190(2) of the Revised Code of Washington also allows the court to grant "other relief." This "other relief" would presumably include restitution accompanying any rescission award, declaratory relief, or other equitable relief, such as an injunction or conceivably a constructive trust in a proper case.

299. WASH. REV. CODE § 19.100.190(3).

300. *Id.* Washington is an outlier with respect to allowing any "prevailing party" to recover its fees in such an action. Most states that authorize claims for registration or disclosure violations allow recovery only by a prevailing franchisee. *See* HAW. REV. STAT. § 482E-9(c) (2008); 815 ILL. COMP. STAT. § 705/26 (2008); IND. CODE § 23-2-2.5-28 (2008); MICH. COMP. LAWS § 445.1531 (2008); MINN. STAT. § 80C.17 (2008); N.Y. GEN. BUS. LAW § 691(1) (McKinney 2008); N.D. CENT. CODE § 51-19-12 (2008); OR. REV. STAT. § 650.020(3) (2008); R.I. GEN. LAWS § 1928.121 (2008) (unless plaintiff knew the facts concerning the violation); S.D. CODIFIED LAWS § 37-5B-49 (2008); VA. CODE ANN. § 13.1-571 (2008). As initially enacted, FIPA mandated a fee award, but only to a prevailing plaintiff. Franchise Investment Protection Act, ch. 252, §19(3), 1971 Wash. Sess. Laws, 1st Ex. Sess. 1140. The statute was amended before its effective date to make a fee award discretionary and to authorize an award to a prevailing franchisor as well as a prevailing franchisee. *Id.* ch. 116, 1972 Wash. Sess. Laws, 2d Ex. Sess. 259. At least one court has approved a fee award based in part on FIPA to a franchisor that prevailed in an action based upon alleged registration and antifraud violations. *Morris v. Int'l Yogurt Co.*, 41 Wash. App. 226, 231-32, 703 P.2d 318 (1985), *rev'd on other grounds*, 107 Wash. 2d 314, 729 P.2d 33 (1986). *But see* *Toppen v. Roy*, Bus. Franchise Guide (CCH) ¶ 12,894 (Wash. Ct. App. Aug. 17, 2004) (area franchisee prevailing under claim brought by other franchisee under section 19.100.190 of the Revised Code of Washington was denied attorneys' fees because court agreed with area franchisee's argument that FIPA did not apply to claim).

301. *Morris*, 41 Wash. App. at 229. It is not entirely clear whether a franchisee must show some injury resulting from the violation before rescission may be awarded. At least one court has required a showing of injury in a case based on the franchisor's failure to register sales agents. *Harb v. Norrell Servs., Inc.*, Bus. Franchise Guide (CCH) ¶ 10,185 (W.D. Wash. Jan. 29, 1993).

302. *Harb*, Bus. Franchise Guide (CCH) ¶ 10,185. Most courts outside of Washington have also held that a statutory claim for rescission under a state franchise statute implicates the defenses and limitations of common law rescission remedy. *See* *Fargo Biltmore Motor Hotel Corp. v. Best*

the antifraud provisions must act promptly to rescind upon learning the facts on which the misrepresentation claim is based.<sup>303</sup> A party “who desires to rescind a contract on the ground of fraud must, upon discovery of the facts, at once (or at least reasonably quickly) announce his purpose and adhere to it.”<sup>304</sup> If the defrauded party discovers the fraud but enters into new agreements or agrees to modify existing agreements, the defrauded party will waive the right to pursue a claim for that fraud.<sup>305</sup>

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Western Int'l, Inc., 742 F.2d 459, 462–63 (8th Cir. 1984) (holding that the plaintiff's claim for rescission was barred on the equitable ground of estoppel because they had failed to rescind promptly after learning that defendant had not registered and had, instead, continued to accept the benefits of the agreement with defendant); *Two Men & a Truck/Int'l, Inc. v. Two Men & a Truck/Kalamazoo, Inc.*, 949 F. Supp. 500, 506 (W.D. Mich. 1996); *Layton v. AAMCO Transmissions, Inc.*, 717 F. Supp. 368, 372 (D. Md. 1989) (holding that two year delay in filing suit, gave franchisees an opportunity to decide whether the profitability of their franchise was acceptable, and their delay made recreation of the conditions existing at the time they entered into the agreement impossible. The franchisees played a game of “heads, we win - tails, you lose,” which barred them from seeking rescission.); *In re Dynamic Enters., Inc.*, 32 B.R. 509, 1983-2 Trade Cases ¶ 65,715 (M.D. Tenn. 1983); *Nielsen v. McCabe*, 442 N.W.2d 477, 481 (S.D. 1989); *Bagel Enters., Inc. v. Baskin & Sears*, 467 A.2d 533, 539–41 (Md. Ct. Spec. App. 1983); Terence McTigue & Donald S. Chisum, *The Rescission Remedy for Franchise Regulation Violations*, 5 FRANCHISE L.J. 1, 17 (1985) (“The majority of cases in fact hold that common law conditions and defenses are applicable.”).

303. *Harb*, Bus. Franchise Guide (CCH) ¶ 10,231 (holding that franchisees waived any rescission right by continuing to accept benefits of franchise agreement, continuing to use the franchisor's service marks, paying royalties, and asking for and obtaining an amendment to their franchise agreements enlarging their exclusive territories after learning of the true facts upon which their misrepresentation claims were based); *Kirkham v. Smith*, Bus Franchise Guide (CCH) ¶ 12,082 (Wash. Ct. App. May 14, 2001) (seven months' delay before seeking rescission is too long; franchisee's actions must be consistent with intent to rescind promptly, and where franchisee made substantial additional investment after learning information underlying misrepresentation claim, franchisee clearly had no intent to rescind until business losses later mounted). See also *McTigue & Chisum*, *supra* note 302, at 17. The same principle applies equally in federal securities actions under SEC Rule 10b-5. See *Gannett Co., Inc. v. Register Publ'g Co.*, 428 F. Supp. 818, 827 (D. Conn. 1977) (“[I]n rule 10b-5 cases the law is well established that rescission must be demanded promptly after discovery of the fraud, or the right to rescission will be lost.”); IX L. LOSS AND J. SELIGMAN, *SECURITIES REGULATION* 4411 (3d ed. 2004).

304. *Grant v. Morris*, 7 Wash. App. 134, 138, 498 P.2d 336 (1972); see also *Coovert v. Ingwersen*, 37 Wash. 2d 797, 803, 226 P.2d 187 (1951) (“Where a party desires to rescind upon the ground of mistake or fraud, he must, upon discovery of the facts, at once announce his purpose and adhere to it, and if he remains silent, and continues to treat the property as his own, he will be held to have waived objection and will be conclusively bound by the contract . . . .”); *Prager's, Inc. v. Bullitt Co.*, 1 Wash. App. 575, 586, 463 P.2d 217 (1969) (“Failure to rescind within a reasonable time of the breach is conduct indicating an election to continue the contract.”) (citing *Longenecker v. Brommer*, 59 Wash. 2d 552, 368 P.2d 900 (1962)).

305. *Weitzman v. Bergstrom*, 75 Wash. 2d 693, 698–99, 453 P.2d 860 (1969) (plaintiff purchased vending machine route that did not generate expected revenues, but the plaintiff's later execution of a revised agreement with the defendant that extended the payment schedule and reduced monthly payments indicated the plaintiff's intent to waive any rescission right based on aging misrepresentation); *Owen v. Matz*, 68 Wash. 2d 374, 376–377, 413 P.2d 368 (1966) (“[W]hen a party claiming to have been defrauded enters after discovery of the fraud into new agreements or engagements concerning the subject matter of the contract claimed to have been procured by fraud, he is deemed to have waived any claim to rescission . . . .”).

FIPA explicitly denies rescission if the defendant franchisor can demonstrate either that the franchisee “knew the facts concerning the untruth or omission,” or that the franchisor exercised reasonable care and did not know or would not have known of the untruth or omission even if exercising reasonable care.<sup>306</sup>

A franchisee entitled to rescission must return to the franchisor all benefits conferred on the franchisee.<sup>307</sup> However, if a benefit conferred by the franchisor has been “consumed” by the franchisee such that it is not susceptible to return, then the franchisor is instead granted an offset to any restitutionary award ordered.<sup>308</sup> If the franchisee has already transferred the franchise to a third person, the benefits cannot be returned to the franchisor, and the franchisee’s rescission right is waived.<sup>309</sup>

Where rescission is appropriate, the court also will require the franchisor to refund all fees paid by the franchisee.<sup>310</sup> However, in the normal case, the franchisee is not entitled to recover its business losses because those losses do not benefit the franchisor and it would be inequitable to require the franchisor to incur that cost.<sup>311</sup>

## 2. Damages

FIPA authorizes damages up to three times a defrauded franchisee’s actual damages,<sup>312</sup> however, there are no reported decisions awarding heightened damages.<sup>313</sup> That result is consistent with Washington courts’

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306. WASH. REV. CODE § 19.100.190(2) (2008). This is similar to the language used in other states’ franchise statutes to excuse from liability the franchisors’ officers or directors who had no knowledge of the wrongdoing. *See, e.g.*, statutes cited *supra* note 297.

307. *Morris v. Int’l Yogurt Co.*, 41 Wash. App. 226, 229 n.4, 703 P.2d 318 (1985) (explaining that rescission is normally a proper remedy and requires the franchisee to tender back all the benefits it has received under the contract), *overruled on other grounds* by 107 Wash. 2d 314, 729 P.2d 33 (1986); *see also* *Fargo Biltmore Motor Hotel Corp. v. Best Western Int’l, Inc.*, 742 F.2d 459, 462–63 (8th Cir. 1984); *Brader v. Minute Muffler Installation, Ltd.*, 81 Wash. App. 532, 537, 914 P.2d 1220 (1996), *amended by* 922 P.2d 825 (1996); *McTigue & Chisum, supra* note 302, at 18.

308. *GR8 Wheels, Inc. v. Morris*, Bus. Franchise Guide (CCH) ¶ 13,770 (Wash. Super. Ct. Oct. 17, 2007).

309. *Morris*, 107 Wash. 2d at 319.

310. *Brader v. Minute Muffler Installation, Ltd.*, 81 Wash. App. 532, 537, 914 P.2d 1220 (1996), *amended by* 922 P.2d 825 (1996).

311. *Brader*, 81 Wash. App. at 537. In dicta, the *Brader* court left open the possibility that the franchisee may have been entitled to its business losses if the franchisor had committed fraud, rather than simply failed to register or provide required pre-sale disclosures. *But see* *Kirkham v. Smith*, 106 Wash. App. 177, 181–82, 23 P.3d 10 (2001) (affirming damages awarded based on operating losses incurred as a result of the violations of section 19.100.170 of the Revised Code of Washington.) In corresponding fashion, the franchisor is not entitled to any offset if the franchisee’s business has been profitable. *GR8 Wheels, Inc.*, Bus. Franchise Guide (CCH) ¶ 13,770.

312. WASH. REV. CODE § 19.100.190(3) (2008).

313. *But see* *GR8 Wheels, Inc.*, Bus. Franchise Guide (CCH) ¶ 13,770 (although not explicitly tracking FIPA’s provisions, the court declined to award exemplary damages because the franchisor’s violations “were not knowingly or intentionally committed”).

history of aversion to punitive or enhanced damages.<sup>314</sup> Treble damages under the statute are therefore probably appropriate only where the defendant's conduct was intentional or morally culpable.<sup>315</sup>

Few court opinions in Washington have considered how damages are to be measured for violations of FIPA's antifraud provisions. In the absence of clear FIPA-specific authority, it is reasonable to presume that "damages" authorized by FIPA are those damages generally available in fraud cases. The leading case in Washington on the proper measure of damages for fraud remains *Salter v. Heiser*, in which the Washington Supreme Court adopted the majority position that fraud damages should be measured by the "benefit of the bargain."<sup>316</sup> This approach defines the defrauded plaintiff's damages as the difference between actual value and the value as fraudulently represented, and is distinguished from the alternative minority approach of measuring fraud damages by the plaintiff's actual out-of-pocket costs resulting from the fraud.<sup>317</sup> The *Salter* Court stated that the "benefit of the bargain" measure of damages is not the "exclusive" measure of damages in Washington.<sup>318</sup> However, the Court clearly differentiated between general damages and consequential damages that are not inherent in the benefit of the bargain.<sup>319</sup> The case does not suggest that Washington would apply the "out of pocket" measure for general damages.<sup>320</sup>

There is little Washington law on the measurement of the expected benefit of the bargain, particularly in the franchise context. Elsewhere, courts have allowed the measure of damages to be established by expert testimony.<sup>321</sup> The franchisee has properly established benefit of the bargain damages where it can provide evidence supporting "both ends" of the damages equation; that is, the value of the franchise as represented

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314. See, e.g., *Fisher Props., Inc. v. Arden-Mayfair, Inc.*, 106 Wash. 2d 826, 852, 726 P.2d 8 (1986).

315. Under FIPA's "relationship" provisions (section 19.100.180), treble damages are only available for Bill of Rights violations where authorized under the Consumer Protection Act. WASH. REV. CODE § 19.100.190(1) (violation of Bill of Rights provision only constitutes unfair and deceptive act under CPA). Even then, heightened damages are discretionary. *Payless Car Rental Sys., Inc. v. Draayer*, 43 Wash. App. 240, 243-44, 716 P.2d 929 (1986) (holding that termination claim did not allow franchisee to obtain exemplary damages, which are only available for claims relating to offer or sale of franchise).

316. 39 Wash. 2d 826, 832, 239 P.2d 327 (1951).

317. *Prescott v. Matthews*, 20 Wash. App. 266, 270, 579 P.2d 407 (1978).

318. *Salter*, 39 Wash. 2d at 832.

319. *Id.*

320. See *Prescott*, 20 Wash. App. at 270 (recognizing split of authority over the two measures, but stating that Washington has adopted "benefit of the bargain").

321. *Crues v. KFC Corp.*, 729 F.2d 1145, 1151 (8th Cir. 1984).

and the true value in the absence of the misleading representation or omission.<sup>322</sup>

A franchisee pursuing a disclosure claim may recover consequential damages in addition to the benefit of the bargain, as long as those damages are not already inherent in the benefit of the bargain.<sup>323</sup> The Court in *Salter* held that some losses, including operating losses and lost wages, are inherent in the “benefit of the bargain” measure of general damages, and are therefore not recoverable in addition to general damages.<sup>324</sup>

In addition, consequential damages must be proximately caused by the defendant’s conduct; that is, such damages must “follow as the natural and ordinary consequences of the wrong.”<sup>325</sup> Proximate cause is generally described as a cause that, in a direct sequence and unbroken by any new independent cause, produced the event complained of, and without which such event would not have happened.<sup>326</sup> For instance, where the defendant’s misrepresentation induced the plaintiff to travel to Japan to negotiate the sale of equipment, the plaintiff’s travel expenses were recoverable as consequential damages.<sup>327</sup> However, the living expenses he incurred while remaining there for six weeks were not recoverable.<sup>328</sup>

In the comparable securities context, consequential damages will require the plaintiff to show both “loss” causation and “transaction” causation.<sup>329</sup> Loss causation requires that the loss be causally related to the alleged misrepresentation, and transaction causation requires that the plaintiff would not have entered into the transaction but for the alleged

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322. *Id.* (damages award was supportable where separate experts had testified about value as represented and value in reality).

323. *Salter*, 39 Wash. 2d at 834.

324. *Id.* The *Salter* Court stated:

The risk of operating at a loss and the giving up of other employment are incidents of entering into a business venture. Where the plaintiff can be awarded the difference between the value of what he would have received had the representations been true and the actual value of what he received, he is adequately compensated. While it is unquestionably true that the fraud may result in a loss in operating a business, where, had the state of things been as represented, it would have returned a profit; that element of damages is reflected in the difference in values computed under the ‘benefit of the bargain’ measure of damages. Further, such a rule removes the speculation attendant in attempting to ascertain what portion of loss is attributable to the fraud and what portion is attributable to bad management or other factors not connected with the fraud. Therefore, plaintiffs’ loss of time and their net operating loss are not allowable items of damages.

*Id.*

325. *McInnis & Co. v. W. Tractor & Equip. Co.*, 67 Wash. 2d 965, 971, 410 P.2d 908 (1966).

326. *See McRae v. Bolstad*, 32 Wash. App. 173, 178, 646 P.2d 771 (1982).

327. *McInnis & Co.*, 67 Wash. 2d at 972.

328. *Id.*

329. *See, e.g., Schlick v. Penn-Dixie Cement Corp.*, 507 F.2d 374, 380 (2d Cir. 1974).

misrepresentation.<sup>330</sup> The purpose of the damage award is to place the injured party in the position she would have been in had the wrong not occurred; thus, the damages recoverable for fraud are not equivalent to the loss attributable to the transaction as a whole.<sup>331</sup> Rather, the finder of fact must “ascertain what portion of the loss is attributable to the fraud and what portion is attributable to bad management or other factors not connected with the fraud.”<sup>332</sup>

Usually, a plaintiff cannot continue to recover damages after discovering the fraud because reliance is no longer justified.<sup>333</sup> Thus, where the plaintiff discovers she has been misled, but does not complain, continues to purchase inventory, and does not seek to terminate the agreement, the plaintiff cannot recover lost profits.<sup>334</sup>

### 3. Statute of Limitations for Registration Violations and Antifraud Liability

FIPA does not contain its own statute of limitations.<sup>335</sup> But Washington has a two-year catch-all limitations period, applicable in any action for which no other limitations period applies.<sup>336</sup> The catch-all limitations period has generally been held applicable to actions upon liabilities created by statute.<sup>337</sup> Indeed, all courts that have addressed the issue have held that where the franchisee’s action is based on the franchisor’s failure to register, or other “technical” violations of FIPA, the

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330. *Id.* See also *Dura Pharm., Inc. v. Broudo*, 544 U.S. 336, 346 (2005); *McCabe v. Ernst & Young, L.L.P.*, 494 F.3d 418, 426 (3d Cir. 2007).

331. See, e.g., *Magna Weld Sales Co. v. Magna Alloys & Research Pty, Ltd.*, 545 F.2d 668, 672 (9th Cir. 1977).

332. *Salter v. Heiser*, 39 Wash. 2d 826, 834, 239 P.2d 327 (1951).

333. See *Magna Weld Sales Co.*, 545 F.2d at 672.

334. *Id.* (“Once the [distributors] became aware of the falsity of representations, they were no longer entitled to rely on them, and they cannot recover losses incurred as a result of their choosing to remain in the business. In fact, it was [the manufacturer] that finally terminated the agreement two years later, and surely, had it not done so, the [distributors] could not have continued to claim ‘lost profits’ indefinitely.”). See also *Bechtel v. Liberty Nat’l Bank, N.A.*, 534 F.2d 1335, 1343 (9th Cir. 1976) (“Since the representor is not a guarantor, the victim of misrepresentation may not irresponsibly accumulate his losses to the detriment of the misrepresentor.” (quoting *Lack Indus., Inc. v. Ralston Purina Co.*, 327 F.2d 266, 281 (8th Cir. 1964))).

335. See discussion *supra* Part III.C.9 for more information about the Governor’s rejection of a limitations period during the 1991 amendments to FIPA.

336. WASH. REV. CODE § 4.16.130 (2008).

337. See *Heitfield v. Benevolent & Protective Order of Keglers*, 36 Wash. 2d 685, 694, 220 P.2d 655 (1950); *Unisys Corp. v. Senn*, 99 Wash. App. 391, 396, 994 P.2d 244 (2000); *cf.* *Northview Motors, Inc. v. Chrysler Motors Corp.*, 227 F.3d 78, 90 (3d Cir. 2000) (applying two-year limitations period for actions seeking a statutory remedy for injuries under Pennsylvania law and citing application of Washington’s two-year statute of limitations to claims for injuries under FIPA).

applicable limitations period is the two-year catch-all limitations period.<sup>338</sup>

For actions based on FIPA's antifraud provisions, the applicable limitations period is less clear. As with technical violations of FIPA, the antifraud provision is a statutorily created liability, and thus, the two-year catch-all limitations period should apply to such claims.<sup>339</sup> Despite this rule, some courts have instead applied the three-year statute of limitation provision that applies to common law claims for fraud.<sup>340</sup>

Another important consideration related to the limitations period for FIPA claims is the application of the discovery rule. Generally, the discovery rule applies to toll the statute of limitations until such time as the plaintiff knew, or through the exercise of due diligence should have known, the facts giving rise to the claim.<sup>341</sup> Although the discovery rule does not toll claims for failure to register,<sup>342</sup> courts have applied it to toll the limitations period for fraud claims where the franchisee demonstrates

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338. *Madison House, Ltd. v. Sotheby's Int'l Realty Affiliates*, Bus. Franchise Guide (CCH) ¶ 13,591 (W.D. Wash. Feb. 20, 2007); *Harb v. Norrell Servs., Inc.*, Bus. Franchise Guide (CCH) ¶ 10,231 (W.D. Wash. Mar. 25, 1993); *Rand v. CM Franchise Sys., Inc.*, No. 61828-8, 2009 WL 667227, (Wash. Ct. App. Mar. 16, 2009). This is also consistent with the intent of Washington's Governor, Booth Gardner, who vetoed a one-year limitations period for failure to register claims because he believed that a two-year period was more reasonable. Governor Booth Gardner, Veto Message on E.S.S.B. 5256, ch. 226, 1991 Wash. Sess. Laws 1141 (May 16, 1991). See also discussion *supra* note 160 for more on the legislative history of FIPA's rejected limitations period. *But see McGowan v. Pillsbury Co.*, 723 F. Supp. 530, 537 (W.D. Wash. 1989) (applying the six-year limitations period applicable to actions on a written contract, found in section 4.16.040(1) of the Revised Code of Washington, for franchisee's claim of breach of the franchise agreement).

339. See *Unisys Corp.*, 99 Wash. App. at 395. Indeed, FIPA's antifraud provisions are different than simple common law fraud. See, e.g., *Kirkham v. Smith*, 106 Wash. App. 177, 183 (2001) (holding that antifraud claims under FIPA, unlike common law fraud claims, do not require proof by clear and convincing evidence). As the legislature created a new cause of action that is different than common law fraud, it stands to reason that the catch-all limitations period applicable to statutorily created liabilities is the appropriate measure for gauging the timeliness of FIPA antifraud claims, rather than the statute of limitations for common law fraud.

340. See *McGowan*, 723 F. Supp. at 535-36. Although the court in *McGowan* rejected the application of the two-year catch-all limitations period to claims under FIPA's antifraud provisions, it did so without addressing FIPA's statutory structure, and without citation to authority or analysis. As such, the decision does not offer strong support for the application of Washington's longer three-year limitation period for claims founded on common law fraud.

341. See, e.g., *Crisman v. Crisman*, 85 Wash. App. 15, 20, 931 P.2d 163 (1997).

342. *Madison House*, Bus. Franchise Guide (CCH) ¶ 13,591; see also *Johnson v. Golf, USA, Inc.*, No. 42905-1-1, 1999 WL 142683 (Wash. Ct. App. Mar. 15, 1999). As the courts noted in both the *Johnson* and *Madison House* decisions, even if the discovery rule applied, that rule postpones the running of a statute of limitations only until the time when a plaintiff, through the exercise of due diligence, discovered or should have discovered the basis for the action. A franchise registration is a public record, and a plaintiff franchisee can easily discover the defendant franchisor's failure to register by calling regulators in Olympia or by reviewing the Securities Division's online database of franchise registrations. Thus, the statute of limitations will begin to run on such a claim, at the latest, upon the sale of the unregistered franchise to the franchisee.

that it could not have discovered the basis for the action before the expiration of the limitations period.<sup>343</sup>

### C. Registration or Disclosure Violations—Misrepresentation Claims

In a private action in which the franchisee elects to affirm the franchise and seeks damages under section 19.100.190 of the Revised Code of Washington based on violations of FIPA's antifraud provisions, the franchisee must show at least a misrepresentation of existing fact, materiality, justifiable reliance, causation, and damages.<sup>344</sup> These elements are generally consistent with Washington common law misrepresentation claims.

As under common law, an actionable misrepresentation under FIPA's antifraud provision must relate to a misrepresentation of an existing fact. Generally, opinions, projections, or promises of future conduct are not actionable as misrepresentations.<sup>345</sup> An actionable misrepresentation may consist of a false affirmative statement.<sup>346</sup> It may consist of a half-truth; that is, the failure "to state a material fact necessary in order to make the statements made in light of the circumstances under which they were made not misleading."<sup>347</sup> And it may consist of a failure to disclose specific facts required to be disclosed in the FDD.<sup>348</sup> However, FIPA does not create a general duty to disclose all material information.<sup>349</sup> Indeed, a

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343. See, e.g., *Rand v. CM Franchise Sys., Inc.*, No. 61828-8, 2009 WL 667227 (Wash. Ct. App. Mar. 16, 2009); *McGowan*, 723 F. Supp. at 535.

344. *Harb v. Norrell Servs., Inc.*, Bus. Franchise Guide (CCH) ¶ 10,231 (W.D. Wash. Mar. 25, 1993).

345. *Id.* See also *Stiley v. Block*, 130 Wash. 2d 486, 505–06, 925 P.2d 194 (1996); *Havens v. C&D Plastics, Inc.*, 124 Wash. 2d 158, 181–82, 876 P.2d 435 (1994) (upholding trial court's grant of directed verdict to defendant on negligent misrepresentation claim because promise of future conduct did not constitute existing fact); *Micro Enhancement Int'l, Inc. v. Coopers & Lybrand, L.L.P.*, 110 Wash. App. 412, 436, 40 P.3d 1206 (2002) ("A false representation as to a presently existing fact is a prerequisite to a misrepresentation claim."). However, an estimate or prediction may constitute a misrepresentation where it was prepared with such egregious disregard for accuracy that it becomes reckless to disseminate it to others. *Robinson v. McReynolds*, 52 Wash. App. 635, 638–39, 762 P.2d 1166 (1988) ("[O]ne who offers an opinion as to the future, knowing of but not disclosing facts that would lead a reasonable person to question the opinion" may have committed an unfair or deceptive act). Promises may be actionable as a misrepresentation only where the promise is made without any present intention to perform, since the making of the promise implies some intention of performance. See *Serv. by Medallion, Inc. v. Clorox Co.*, 44 Cal. App. 4th 1807, 1816, 52 Cal. Rptr. 2d 650 (1996); *Auble v. Auble*, 866 P.2d 1239, 1244 (Or. Ct. App. 1993).

346. WASH. REV. CODE § 19.100.170 (2008); see also *Harb*, Bus. Franchise Guide (CCH) ¶ 10,185 (W.D. Wash. Jan. 29, 1993).

347. WASH. REV. CODE § 19.100.170(2).

348. *Id.*

349. *Harb*, Bus. Franchise Guide (CCH) ¶ 10,185. This is consistent with Washington common law. In general, under Washington misrepresentation law, silence, or the failure to disclose a material fact, is not actionable as a misrepresentation, at least absent a fiduciary relationship or a situation in which one party knows that the other party is acting under a mistake as to the undisclosed fact. "There

franchisor is restricted in making any disclosures regarding the information most important to a prospective franchisee—information about its franchisee's sales or gross or net profits.<sup>350</sup>

As is the case under common law, an actionable misrepresentation under FIPA must be “material.” Materiality is assessed by the importance a reasonable investor would place on the misrepresented fact.<sup>351</sup> Materiality is usually a question of fact.<sup>352</sup> Whether a fact is or is not material must not be assessed in isolation, but in light of whether knowledge of the true facts would have significantly altered the total mix

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is no general requirement under Washington law of full disclosure of all relevant facts in every business relationship.” *Gen. Ins. Co. v. Fort Lauderdale P’ship*, 740 F. Supp. 1483, 1491 (W.D. Wash. 1990); *Haberman v. Wash. Pub. Power Supply Sys.*, 109 Wash. 2d 107, 166–67, 744 P.2d 1032 (1987), *amended by* 750 P.2d 254 (1988); *Gilliland v. Mount Vernon Hotel Co.*, 51 Wash. 2d 712, 321 P.2d 558 (1958); *Tokarz v. Frontier Fed. Sav. & Loan Ass’n*, 33 Wash. App. 456, 458–59, 656 P.2d 1089 (1982). The franchisor/franchisee relationship is not a fiduciary relationship that would give rise to a duty to disclose. *D&K Foods, Inc. v. Bruegger’s Corp.*, *Bus. Franchise Guide (CCH)* ¶ 11,506 (D. Md. 1998); *Corp v. Atlantic Richfield Co.*, 122 Wash. 2d 574, 586, 860 P.2d 1015 (1993). *See also* *Chiarella v. United States*, 445 U.S. 222, 231–33 (1980) (Absent a fiduciary relationship, neither section 10(b) of the 1934 Securities Act, nor Securities Exchange Commission Rule 10b-5, imposes an affirmative duty to disclose all material facts.); *Jett v. Sunderman*, 840 F.2d 1487, 1492–93 (9th Cir. 1988) (Rule 10b-5 is violated by nondisclosure only when there is a duty to disclose.). This is consistent with the FTC’s new requirements concerning quarterly updates to the FDD to reflect material changes. That provision requires franchisors to update the FDD “to reflect any material change to the disclosures included, or required to be included, in the disclosure document.” 16 C.F.R. § 436.7(b) (2008). Thus, the facts in the FDD must be accurate, and all facts required to be in the FDD must be included, but the franchisor does not have any other general disclosure obligation to prospective franchisees.

350. Under the FTC disclosure rule, a franchisor may make statements about other franchisees’ financial performances (referred to as a “financial performance representation”) only in Item 19 of the disclosure document, and only under strict limits about what may be disclosed and how it may be described. A franchisor does not have to make a financial performance representation in Item 19, and in fact, most franchisors do not. David J. Kaufmann, *Mandatory Earnings Claim Disclosure: The Case Against*, 15 *FRANCHISE L.J.* 3, 6 (1995) (noting that approximately 25% of franchisors make formal financial performance representations in their Item 19 disclosures). Instead, the franchisor must make the following negative disclosure in Item 19:

We do not make any representations about a franchisee’s future financial performance or the past financial performance of company-owned or franchised outlets. We also do not authorize our employees or representatives to make any such representations either orally or in writing. If you are purchasing any existing outlet, however, we may provide you with the actual records of that outlet. If you receive any other financial performance information or projections of your future income, you should report it to the franchisor’s management by contacting [name, address, and telephone number], the Federal Trade Commission, and the appropriate state regulatory agencies.

*See* NASAA GUIDELINES, *supra* note 137, at 58. If the franchisor does not make a financial performance representation in Item 19 of the FDD, the franchisor may not make any written or oral financial performance representations as part of the sales process, even a truthful and non-misleading representation. *Id.*

351. *Morris v. Int’l Yogurt Co.*, 107 Wash. 2d 314, 328–29, 729 P.2d 33 (1986).

352. *Id.*

of information available to the plaintiff franchisee.<sup>353</sup> The materiality requirement means that sales talk or puffing—“you cannot lose” or “this is a great investment”—is not actionable because the assertions are so vague or so exaggerated that a reasonable investor would not rely on such statements in considering the “total mix” of information.<sup>354</sup>

The necessary state of mind for an actionable misrepresentation under FIPA is uncertain. Borrowing from the requirements of a federal securities claim, the federal district court in *Harb v. Norrell Services, Inc.* held that proof of a claim requires proof of scienter.<sup>355</sup> More recently, however, the court of appeals stated in dicta that a plaintiff need not prove scienter, suggesting that a merely negligent misrepresentation is actionable.<sup>356</sup> Ultimately, the franchisor’s state of mind may have little practical consequence because most innocent misrepresentations will not be material, and even when material, they may render the franchisee’s reliance unjustified.<sup>357</sup> Where a franchisor has inadvertently misrepresented a material fact, and that misrepresentation induces reasonable

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353. A fact is material only if there is a “substantial likelihood that, *under all the circumstances*, the [misrepresented fact] would have assumed actual significance in the deliberations of the reasonable [investor]. Put another way, there must be a substantial likelihood that the disclosure of the [true facts] would have been viewed by the reasonable investor as having significantly altered the ‘total mix’ of information made available.” *Harb*, Bus. Franchise Guide (CCH) ¶ 10,231 (quoting *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438 (1976)) (emphasis in original). See also *Toppen v. Roy*, Bus. Franchise Guide (CCH) ¶ 12,894 (Wash. Ct. App. Aug. 17, 2004).

354. *Hoxworth v. Blinder, Robinson & Co.*, 903 F.2d 186, 200–01 (3d Cir. 1990) (quoting *TSC Indus.*, 426 U.S. at 449).

355. *Harb*, Bus. Franchise Guide (CCH) ¶ 10,231.

356. *Kirkham v. Smith*, Bus. Franchise Guide (CCH) ¶ 12,082 (Wash. Ct. App. May 14, 2001). The *Kirkham* court relied on the Washington Supreme Court’s decision in *Kittilson v. Ford*, 93 Wash. 2d 223, 225, 608 P.2d 264 (1980), which held that proof of scienter is not required to prove a claim under the Washington Securities Act. However, the *Kirkham* court did not consider the differences between the remedies available under the securities statute (rescission plus interest) and FIPA (rescission and/or actual damages) and whether these differences justified a different standard for claims under FIPA. The *Kirkham* opinion is also cited in *Toppen*, Bus. Franchise Guide (CCH) ¶ 12,894, to support the proposition that, “[u]nlike common law fraud, [Revised Code of Washington §] 19.100.170(2) applies to an *unintentional* misrepresentation or omission.” See also Chisum, *supra* note 1, at 369 (citing *Shermer v. Baker*, 2 Wash. App. 845, 855–58, 472 P.2d 589 (1970), for the proposition that the intent to deceive need not be shown to support a violation under Washington’s Securities Act). The better analysis—and more consistent with traditional analysis under fraud and securities claims—would explicitly turn on the nature of the relief sought. Where rescission is the only remedy sought, the plaintiff should not have to show any intent by the defendant, because it is reasonable to allow the unwinding of a contract that is not as represented, even if the misrepresentation or omission is unintentional. But, where a plaintiff seeks damages, the plaintiff should be required to show that those damages were the result of the defendant’s recklessness in preparing or providing information or the defendant’s intent to mislead.

357. For instance, a franchisee would be hard-pressed to justify its reliance on an inadvertent representation in a disclosure document that the initial franchise fee is \$10 instead of the true \$10,000.

reliance, the franchisor's innocent state of mind should not excuse the error.

The franchisor will not be liable unless the franchisee provides sworn testimony that its decision to purchase the franchise was influenced by the franchisor's false statement or omission.<sup>358</sup> Where a franchisee knows the true facts before entering into a franchise agreement, there can be no justifiable reliance.<sup>359</sup> Usually, a plaintiff cannot continue to recover damages after discovering the fraud, because reliance is no longer justified.<sup>360</sup>

A disclaimer in a disclosure document or franchise agreement does not preclude justifiable reliance on an inconsistent misrepresentation. However, a franchisee relying on a representation that is inconsistent with the express terms of a franchise agreement or disclosure document must provide a plausible explanation to justify that reliance in light of the inconsistency.<sup>361</sup> The plaintiff is generally required to prove that he in fact relied on the misrepresentation and that his reliance was justifiable; however, where the franchisor has failed to disclose a material fact, the franchisee's reliance may be presumed.<sup>362</sup> The burden then shifts to the franchisor to prove that the franchisee would have made the same deci-

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358. Dale v. Black, 81 Wash. App. 599, 603, 915 P.2d 1116 (1996).

359. See Corp v. Atlantic-Richfield Co., 67 Wash. App. 520, 528-29, 837 P.2d 1030 (1992), *rev'd on other grounds*, 122 Wash. 2d 574, 860 P.2d 1015 (1993).

360. See Magna Weld Sales Co. v. Magna Alloys & Research Pty, Ltd., 545 F.2d 668, 672 (9th Cir. 1977).

361. Harb v. Norrell Servs., Inc., Bus. Franchise Guide (CCH) ¶ 10,231 (W.D. Wash. Jan. 29, 1993).

362. See Morris v. Int'l Yogurt Co., 107 Wash. 2d 314, 328, 729 P.2d 33 (1986). In *Morris*, the Washington Supreme Court borrowed from the standard announced in *Affiliated Ute Citizens of Utah v. United States*, 406 U.S. 128 (1972), for federal securities actions under SEC Rule 10b, and held that where a claim against the franchisor under FIPA is based upon a failure to disclose a material fact required to be disclosed, a plaintiff need not prove reliance in fact. In such cases, reliance is presumed, and a defendant may rebut the presumption by proving that the plaintiff's decision would have been the same even if the omitted fact had been disclosed. By adopting the *Affiliated Ute* presumption, the Court implied that it would also consider the subsequent refinements to the *Affiliated Ute* presumption in federal securities law cases. As such, the *Affiliated Ute* presumption may not apply in a case that involves both nondisclosures and affirmative misrepresentations. See, e.g., Joseph v. Wiles, 223 F.3d 1155, 1162-63 (10th Cir. 2000) (presumption does not apply unless case primarily involves omissions); Cavalier Carpets, Inc. v. Caylor, 746 F.2d 749, 756-57 (11th Cir. 1984); Lubin v. Sybedon Corp., 688 F. Supp. 1425, 1446-47 (S.D. Cal. 1988). Further, the presumption may not apply in a case where the plaintiff claims that disclosure was required to make affirmative statements not misleading, though it was in such a case that *Morris* adopted the *Affiliated Ute* presumption. Abell v. Potomac Ins. Co., 858 F.2d 1104, 1119 (5th Cir. 1988), *vacated on other grounds*, 426 U.S. 438 (1989); Smith v. Ayres, 845 F.2d 1360, 1363 (5th Cir. 1988). At the very least, the *Affiliated Ute* presumption should not depend on how the plaintiff characterizes its claim, given that even a lie can be characterized as a failure to disclose the facts that made the statement false. See *In re Salomon Analyst Metromedia Litig.*, 236 F.R.D. 208, 219 (S.D.N.Y. 2006) (“[A]ffirmative misleading statements always omit something; namely, they omit the information that would correct or mitigate their misleading nature and thereby render the statements true.”).

sion to purchase the franchise even if the omitted fact had been disclosed.<sup>363</sup> The burden of proof for FIPA misrepresentation and fraud claims is preponderance of the evidence.<sup>364</sup>

A franchisee seeking damages for misrepresentation must establish that the misrepresentation caused the franchisee's injury.<sup>365</sup> It is not enough to show that a violation of FIPA occurred; the franchisee must establish that the violation caused the claimed damages.<sup>366</sup> Where the franchisee knew the truth of the matter and failed to protect its own interests, recovery will be barred.<sup>367</sup>

#### *D. Relationship Provisions*

Although most of FIPA's attention is directed at the franchisor's pre-sale registration and disclosure obligations, the Act devotes one section to the post-sale relationship between franchisee and franchisor. This Part is divided into two sections. Subsection 1 deals with parties' duty of good faith. Subsection 2 is much broader and outlines the "Franchisee Bill of Rights,"<sup>368</sup> ten specific restrictions on a franchisor's post-sale conduct. Conduct proscribed by subsection 2 is deemed to be "an unfair

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363. *Morris*, 107 Wash. 2d at 328–29. See also *Toppen v. Roy*, Bus. Franchise Guide (CCH) ¶ 12,894 (Wash. Ct. App. Aug. 17, 2004).

364. *Kirkham v. Smith*, Bus. Franchise Guide (CCH) ¶ 12,082 (Wash. Ct. App. May 14, 2001) (reasoning that, because FIPA differs from common law fraud in allowing liability even for unintentional misrepresentations or omissions, a claim under FIPA likewise would depart from the higher standard of proof required in common law misrepresentation claims (citing *Kittilson v. Ford*, 93 Wash. 2d 223, 225, 608 P.2d 264 (1980), which held that, under similar Washington Securities Act, statutory securities fraud claim did not require proof of scienter and therefore differed from common law fraud claim)).

365. See *Toppen*, Bus. Franchise Guide (CCH) ¶ 12,894.

366. *Morris*, 107 Wash. 2d at 319 (holding that franchisee's showing that franchisor failed to register offering was, in itself, insufficient to justify damages). This limitation may effectively preclude a damage recovery based solely on the failure to register. See also *Chisum*, *supra* note 1, at 384 (stating that even with a technical registration or disclosure violation, in the absence of misrepresentation or deception, "[i]t is not clear what measure of damages is intended [by FIPA] or how a franchisee can show that this type of violation caused him damage"). However, rescission is still available upon sale of an unregistered franchise. *Morris*, 107 Wash. 2d at 319 (stating in dicta that rescission would have been granted for sale of unregistered franchise but for the franchisee's transfer of the franchise prior to bringing suit); *GR8 Wheels, Inc. v. Morris*, Bus. Franchise Guide (CCH) ¶ 13,770 (Wash. Super. Ct. Oct 17, 2007) (holding that rescission remedy does not require that the franchisee suffer any business losses). This is consistent with the principle that the franchisor's failure to register its offering renders the franchise agreement voidable, but not inherently void. See *Allison v. Medicab Int'l, Inc.*, 92 Wash. 2d 199, 203–04, 597 P.2d 380 (1979).

367. *Toppen*, Bus. Franchise Guide (CCH) ¶ 12,894 (holding that where the new franchisee worked in the franchised business for several years before purchasing it from the prior franchisee, his conclusory statement that he believed the franchise license to be broader than it was, was not sufficient to establish damages caused by the prior franchisee's purported concealment).

368. See discussion *supra* note 260.

or deceptive act or practice or an unfair method of competition,”<sup>369</sup> that is actionable, if at all, under Washington’s Consumer Protection Act (CPA).<sup>370</sup>

### 1. Duty of Good Faith Under Section 19.100.180(1) of the Revised Code of Washington

Section 19.100.180(1) of the Revised Code of Washington directs both franchisor and franchisee to “deal with each other in good faith.” What little legislative history exists suggests that this provision was intended simply as an affirmation of an implied contractual duty of good faith.<sup>371</sup> FIPA itself provides no express remedy for either party’s breach of the duty of good faith, and at least one court has held that the legislature did not intend to declare a breach of the statutory provision as actionable under FIPA.<sup>372</sup>

While the scope of the contractual duty of good faith may have been unclear when FIPA was enacted, Washington courts have since recognized that the duty of good faith does not operate to create rights not contracted for, nor does it override the express terms of a contract. The Washington Supreme Court explained in the leading case of *Badgett v. Security State Bank*:

[The duty of good faith] obligates the parties to cooperate with each other so that each may obtain the full benefit of performance. However, the duty of good faith does not . . . “inject substantive terms into the parties’ contract.” Rather it requires only that the parties perform in good faith the obligations imposed by their agreement.

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369. WASH. REV. CODE § 19.100.180(2) (2008).

370. *Id.*; see generally *id.* § 19.86; see also *AAMCO Transmissions, Inc. v. Harris*, 759 F. Supp. 1141, 1146 (E.D. Pa. 1991); *Chico’s Pizza Franchises, Inc. v. Sisemore*, Bus. Franchise Guide (CCH) ¶ 8,041 (E.D. Wash. Aug. 29, 1983).

371. Fletcher, *supra* note 22, at 164 (“The requirements of good faith and rejection of unconscionable dealings must be affirmatively provided in this section in view of the decisions various courts have given with regard to termination of franchises.”). FIPA’s enactment predated the adoption of the Restatement of Contracts (Second) in 1979, and its recognition of an implied covenant of good faith and fair dealing. RESTATEMENT (SECOND) OF CONTRACTS § 205 (1979). While most, if not all, states have since recognized and applied the duty as part of their common law, this result was not so obvious when FIPA was adopted. See, e.g., *English v. Fischer*, 660 S.W.2d 521, 522 (Tex. 1983) (refusing to recognize that a duty of good faith is implied in every contract).

372. *Chico’s Pizza*, Bus. Franchise Guide (CCH) ¶ 8,041. The issue of whether a claim for breach of the duty of good faith is actionable was also raised in *AAMCO Transmissions, Inc. v. Harris*, 759 F. Supp. 1141, 1146 (E.D. Pa. 1991). In that case, the court concluded that, unlike the other provisions in section 19.100.180 of the Revised Code of Washington, which are actionable as unfair or deceptive acts under the CPA, the good faith provision is not actionable under the CPA. *Id.* at 1145 n.6. See discussion *infra* Part V.D for additional information about FIPA claims made under the CPA.

Thus, the duty arises only in connection with terms agreed to by the parties.<sup>373</sup>

The duty of good faith also applies where the contract grants one party discretionary authority.<sup>374</sup> In such cases, the duty of good faith requires that the party exercise its contractual discretion in a manner that is consistent with the parties' reasonable expectations as expressed in their contract.<sup>375</sup> For instance, in *Goodyear Tire & Rubber Co. v. Whiteman Tire, Inc.*, the court held that where the parties' contract authorized the manufacturer to compete in the dealer's trade area, the manufacturer did not violate the duty of good faith by operating its own retail facility that competed with the dealer, even though the manufacturer's retail location allegedly drove the dealer out of business by selling products for lower prices.<sup>376</sup> Similarly, a marine outboard motor manufacturer did not breach the duty of good faith by choosing to not renew its agreement with a distributor where the express language of the distributorship agreement did not obligate renewal of the relationship at the end of the term.<sup>377</sup>

## 2. Franchisee Bill of Rights

FIPA's Bill of Rights provisions are based on the assumption that franchisors have superior bargaining power, and that they often (if not usually) take advantage of this power by exercising it arbitrarily and unfairly. As the Washington Supreme Court noted in *Coast to Coast Stores, Inc. v. Gruschus*:

The franchisor normally occupies an overwhelmingly stronger bargaining position and drafts the franchise agreement so as to maximize his power to control the franchisee. Franchisors have used this power to terminate franchises arbitrarily, to coerce franchisees under threat of termination, and to force franchisees to purchase supplies from the franchisor or approved suppliers at unreasonable prices, to carry excessive inventories, to operate long, unprofitable hours, and to employ other unprofitable practices.<sup>378</sup>

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373. 116 Wash. 2d 563, 569, 807 P.2d 356 (1991) (citations omitted).

374. See generally Douglas C. Berry, David M. Byers & Daniel J. Oates, *Open Price Agreements: Good Faith Pricing in the Franchise Relationship*, 27 FRANCHISE L.J. 45 (Summer 2007) (stating that an agreement granting one party the discretion to set the price of goods in a long term purchasing arrangement must be performed in good faith).

375. *Id.*

376. 86 Wash. App. 732, 737-41, 935 P.2d 628 (1997).

377. *Bryant Corp. v. Outboard Marine Corp.*, Bus. Franchise Guide (CCH) ¶ 10,604 (W.D. Wash. Sep. 29, 1994), *aff'd*, Bus Franchise Guide (CCH) ¶ 10,852 (9th Cir. Feb. 6, 1996).

378. 100 Wash. 2d 147, 150, 667 P.2d 619 (1983) (quoting Chisum, *supra* note 1, at 297-98).

These assumptions were not based on any serious investigation of franchising practices or on complaints from actual franchisees; rather, these assumptions were based on anecdotal evidence, more often than not involving reports from victims of multi-level marketing schemes and “business opportunities.”<sup>379</sup> The reality now—if it was not when FIPA was enacted—is that franchisees are often wealthier and more sophisticated than the franchisor they deal with, and any power the franchisor may have is often constrained by competition with other franchisors for a franchisee’s business.<sup>380</sup> The legislature’s response to the presumed problem was to impose specific limitations on franchisor behavior in FIPA’s Bill of Rights.<sup>381</sup>

FIPA’s Bill of Rights provisions were controversial when enacted.<sup>382</sup> The provisions themselves were modeled on a Massachusetts bill that was never adopted.<sup>383</sup> The scope of the Bill of Rights is broad, and it remains one of the most far-reaching franchisee/franchisor relationship statutes in the United States.<sup>384</sup> Often vague and sometimes

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379. Fletcher, *supra* note 22, at 2; *see also* discussion *supra* Part III.

380. *See* Killion, *supra* note 37, at 28 (“[M]ulti-unit [franchisee] operators are a large and significant component of the franchising landscape today. Indeed, the multi-unit operator has become the target franchisee for many franchisors. As a consequence, the uniform franchise agreement present in the marketplace today is frequently written to attract sophisticated franchisees that are candidates to become multiunit operators.”); ROGER D. BLAIR & FRANCINE LAFONTAINE, *THE ECONOMICS OF FRANCHISING* 49–50 (2005) (“[M]any multi-unit franchisees are large and sophisticated companies. In fact, data imply that the largest 200 franchisees are larger on average than the typical (median) franchisor.”).

381. Fletcher, *supra* note 22, at 13 (stating that FIPA’s relationship provisions were intended to “equalize the powers of the respective parties”).

382. Chisum, *supra* note 1, at 335.

383. *Id.* *See also* Fletcher, *supra* note 22, at 11 n.8, app. B.

384. Since FIPA’s enactment, seventeen states have adopted some sort of franchise relationship statutes. Usually, these statutes are of limited scope, dealing principally with termination or nonrenewal of a franchise, though some of these statutes also include some additional franchisee protections. *See* Arkansas Franchise Practices Act, ARK. CODE ANN. §§ 4-72-204–206 (2008) (termination, nonrenewal, good faith, transfers, advertising, franchisee association); California Franchise Relations Act, CAL. BUS. & PROF. CODE §§ 20020–27, 20040.5 (West 2008) (termination, succession, nonrenewal); California Franchise Investment Law, CAL. CORP. CODE § 31220 (West 2008) (franchisee association); Connecticut Franchise Act, CONN. GEN. STAT. § 42-133f (2008) (termination and nonrenewal); Delaware Franchise Security Law, DEL. CODE ANN. tit. 6, § 2552 (2008) (termination and nonrenewal) Illinois Franchise Disclosure Act of 1987, 815 ILL. COMP. STAT. §§ 705/17–20 (2008) (franchisee association, discrimination, termination, nonrenewal); Michigan Franchise Investment Law, MICH. COMP. LAWS § 445.1527 (2008) (franchisee association, termination, nonrenewal, transfers, forum selection); Minnesota Franchise Act, MINN. STAT. § 80C.14 (2008) (termination, nonrenewal, transfer, succession); Mississippi, MISS. CODE ANN. § 75-24-53 (2008) (termination and nonrenewal); Missouri Franchise Law, MO. REV. STAT. § 407.410 (2008) (termination and nonrenewal); Nebraska Franchise Law, NEB. REV. STAT. §§ 87-404–406 (2008) (termination, nonrenewal, transfers, succession, franchisee association, imposition of unreasonable standards of performance); New Jersey Franchise Practices Act, N.J. STAT. ANN. § 56:105-107 (2008) (termination, nonrenewal, transfers, succession, franchisee association, imposition of unreasonable standards of performance); Rhode Island Fair Dealership Act, R.I. GEN. LAWS

circular, the Bill of Rights provisions would likely be a candidate for any “worst drafted statute” contest.

The Bill of Rights provisions, however, have not had the dramatic impact many envisioned when first enacted, at least in the sense that they have not generated extensive litigation. There have been surprisingly few reported cases under any of the Bill of Rights provisions, and even fewer cases in which the plaintiff has enjoyed even limited success. In part, this may be because franchisor misconduct was not as prevalent as the legislature assumed. But, it is also because FIPA itself provides no remedy for any violation of any of the Bill of Rights provisions. Instead, section 19.100.180(2) of the Revised Code of Washington provides that a violation of any of its provisions is regarded as an “unfair or deceptive act or practice” that is actionable only under Washington’s CPA. The Washington Supreme Court has held, however, that while FIPA makes a violation of a Bill of Rights provision an “unfair act or practice” under the CPA, a violation of FIPA does not by itself establish a CPA violation.<sup>385</sup> A plaintiff also must show that the violation (1) occurred in trade or commerce; (2) affects the public interest; (3) injures the plaintiff’s business or property; and (4) causes the injury suffered by plaintiff.<sup>386</sup>

This significant restriction on the scope of FIPA’s Bill of Rights provisions is not unique. Hawaii’s Franchisee Bill of Rights, largely modeled on FIPA, also makes a violation of one of its provisions an

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§ 6-50-4 (2008) (termination and nonrenewal); Rhode Island Franchise Investment Act, R.I. GEN. LAWS § 1928.116 (2008) (franchisee association); Virginia Retail Franchising Act, VA. CODE ANN. § 13.1-564 (2008) (termination and nonrenewal); Wisconsin Fair Dealership Law, WIS. STAT. § 135.03 (2008) (termination and nonrenewal). Only a few states have adopted broad statutory protections similar to Washington’s Franchisee Bill of Rights. See Hawaii Franchise Investment Law, HAW. REV. STAT. § 482E-6 (2008) (similar to Washington’s Bill of Rights, but franchisees may have no right to enforce the Act’s provisions); see *Lui Ciro, Inc. v. Ciro, Inc.*, 895 F. Supp. 1365, 1387–88 (D. Haw. 1995) (holding that because a franchisee is not a consumer, only the state could maintain an action based on a violation of Hawaii’s Franchisee Bill of Rights provisions). See also Indiana Deceptive Franchise Practices Act, IND. CODE § 23-2-2.7-2 (2008) (designated suppliers, encroachment, supplier rebates, product pricing, termination, nonrenewal, post-term noncompetition covenants, participation in advertising programs, coerced purchases of goods, succession, discrimination, supplier rebates); Iowa 2000 Franchise Act, IOWA CODE § 537(A).10 (2008) (transfers, encroachment, termination, nonrenewal, designated suppliers, franchisee association, good faith). The Iowa Act applies to franchises entered into after July 1, 2000; there exists another act for franchises entered into after 1992. See Iowa 1992 Franchise Act, IOWA CODE § 523(H).1 (2008). The territory of Puerto Rico has also enacted franchise relationship provisions. See Puerto Rico Dealer’s Act of 1964, P.R. LAWS ANN. tit. 10, §§ 278a, 278b-3 (2008) (termination, nonrenewal, forum selection).

385. *Nelson v. Nat’l Fund Raising Consultants, Inc.*, 120 Wash. 2d 382, 393, 842 P.2d 473 (1992).

386. *Id.* The Washington Supreme Court established the five elements of a CPA action in *Hangman Ridge Training Stables, Inc. v. Safeco Title Ins. Co.*, 105 Wash. 2d 778, 784–853, 719 P.2d 531 (1986). See also *Leingang v. Pierce County Med. Bureau*, 131 Wash. 2d 133, 149, 930 P.2d 288 (1997).

“unfair or deceptive act or practice” under Hawaii’s CPA.<sup>387</sup> However, Hawaii’s CPA affords a private right of action only to consumers, and, in Hawaii, franchisees are not consumers.<sup>388</sup>

The greatest hurdle to any franchisee challenge under the CPA is the requirement that the challenged conduct must affect the public interest. In a number of cases, courts have characterized the dispute between franchisee and franchisor as merely a “private dispute” outside the reach of the CPA.<sup>389</sup> The court of appeals’ decision in *Goodyear Tire & Rubber Co. v. Whiteman Tire, Inc.*<sup>390</sup> illustrates that approach. In *Goodyear*, the plaintiff had entered into a long-term distributorship agreement with Goodyear to sell Goodyear’s tires.<sup>391</sup> The plaintiff claimed that, as part of the agreement, Goodyear had promised not to open competing retail outlets.<sup>392</sup> When Goodyear began opening its own retail outlets near the plaintiff’s store, the plaintiff sued, claiming that Goodyear’s competition with dealers violated the CPA.<sup>393</sup> The court of appeals concluded that the plaintiff could not satisfy the Act’s public interest requirement because Goodyear’s conduct was not directed at the public; rather, it related only to the dealers with whom Goodyear had distributor agreements.<sup>394</sup> Moreover, the court distinguished the plaintiff and other dealers from average consumers, stating that as businessmen, they were not “representative of bargainners vulnerable to exploitation” that the CPA was designed to protect.<sup>395</sup>

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387. HAW. REV. STAT. § 482E-9(a) (2008) (“The commission of any unfair or deceptive acts or practices or unfair methods of competition prohibited by section 482E-6 shall constitute an unfair or deceptive act or practice under chapter 480.”).

388. *Lui Ciro, Inc.*, 895 F. Supp. at 1388 (holding that because a franchisee is not a consumer, only the state could maintain an action based on a violation of Hawaii’s Franchisee Bill of Rights provisions).

389. See, e.g., *Abbouds’ McDonald’s, L.L.C. v. McDonald’s Corp.*, No. CV-04-1895P, 2005 WL 2656591 (W.D. Wash. Oct. 14, 2005) (franchisee failed to show any members of the public at large were at risk of being similarly injured by the defendant), *aff’d*, Bus. Franchise Guide (CCH) ¶ 13,370 (9th Cir. July 7, 2006); *SPX Corp. v. Shop Equip. Specialists, Inc.*, Bus. Franchise Guide (CCH) ¶ 12,171 (W.D. Mich. Mar. 28, 2001) (holding that franchisor did not violate CPA because franchisee had failed to show the likelihood that others could be harmed in the same way as the claimant); *D&K Foods, Inc. v. Bruegger’s Corp.*, Bus. Franchise Guide (CCH) ¶ 11,506 (D. Md. Sept. 30, 1998) (holding that franchisor’s alleged misrepresentations were not actionable under CPA because the plaintiff failed to specify how the public had been or was likely to have been affected by the alleged conduct, and because the transactions did not involve the public in any way, and, in fact, “were complex, arm’s length commercial transactions between highly experienced and sophisticated parties”).

390. 86 Wash. App. 732, 935 P.2d 628 (1997).

391. *Id.* at 735.

392. *Id.* at 736–37.

393. *Id.* at 738.

394. *Id.* at 744.

395. *Id.* at 745. See also *Hambleton Bros. Lumber Co. v. Balkin Enters., Inc.*, 397 F.3d 1217, 1235 (9th Cir. 2005) (holding that plaintiff did not meet public interest requirement where there was

*i. Right of Association*

The Franchisee Bill of Rights makes it unlawful for a franchisor to restrict or inhibit the right of franchisees to join an association of franchisees.<sup>396</sup> The Act does not mandate that a franchisor recognize or bargain with any franchisee association, and it does not define what constitutes “an association of franchisees” or how and when an association may legitimately represent the interests of all franchisees. The provision merely prohibits a franchisor from preventing a franchisee from joining a franchisee association. Indeed, the legislative history suggests that the provision was intended only to invalidate “yellow dog” provisions in franchise agreements.<sup>397</sup>

Quite apart from any protection provided in FIPA, franchisee associations have become almost commonplace since FIPA was enacted.<sup>398</sup> The existence of a brand-specific franchisee association that is created, sponsored, or endorsed by a franchisor is now something that must be disclosed in the FDD under the FTC disclosure rule.<sup>399</sup>

Outside of Washington, a number of cases in recent years have addressed whether a franchisee association has standing to assert claims

no evidence of active solicitation or public advertising by defendant, and no evidence the parties occupied unequal bargaining positions); *Swartz v. KPMG, L.L.C.*, 401 F. Supp. 2d 1146, 1154 (W.D. Wash. 2004) (“As a matter of law, conduct directed toward only a small group cannot support a CPA claim.”), *aff’d in part*, 476 F.3d 756 (9th Cir. 2007); *Segal Co. v. Amazon.com*, 280 F. Supp. 2d 1229, 1234 (W.D. Wash. 2003) (holding that the plaintiff did not meet the public interest requirement when there were “no specific facts suggesting that defendant has engaged in a generalized pattern of solicitation”).

396. WASH. REV. CODE § 19.100.180(2)(a) (2008).

397. See Fletcher, *supra* note 22, at 164. “‘Yellow dog’ contracts are employment contracts in which workers promise not to join a union in order to obtain employment.” Katherine Van Wezel Stone, *Mandatory Arbitration of Individual Employment Rights: The Yellow Dog Contract of the 1990s*, 73 DENV. U. L. REV. 1017, 1037 n.146 (1996). Yellow dog contracts were common in the first few decades of the twentieth century after the practice was sanctioned by the United States Supreme Court. *Id.* (citing *Hitchman Coal & Coke Co. v. Mitchell*, 245 U.S. 299 (1917), and *Coppage v. Kansas*, 236 U.S. 1 (1915)). “The practical result of these decisions, however, was to disable labor from organizing altogether. Indeed, the dissent in *Coppage* argued that the Court’s ruling denied workers their right of association.” Kenneth A. Stahl, *The Suburb as a Legal Concept: The Problem of Organization and the Fate of Municipalities in American Law*, 29 CARDOZO L. REV. 1193, 1222 (2008). Congress eventually passed legislation invalidating yellow dog contracts. 29 U.S.C. § 103 (2006).

398. *Thirty Years of Franchising*, 27 FRANCHISE L.J. 85, 92 (2007) (“Far and away the biggest evolutionary change [in the last 30 years] is the emergence across the spectrum of franchising of general purpose independent associations of franchisees. These associations have evolved to the stature (in many cases) of autonomous trade associations, with professional management and top-level professional resources, ranging from legal advisors to finance and accounting, strategic positioning research, marketing and advertising, and supply-chain management.”).

399. 16 C.F.R. § 436.5(t)(8)(i) (2008). The FTC rule also requires disclosure of franchisee associations that (1) are incorporated under state law, and (2) have specifically requested that the franchisor include the association in the franchisor’s disclosure document for the next fiscal year. *Id.* § 436.5(t)(8)(ii).

on behalf of its members. Most of these claims have been unsuccessful.<sup>400</sup> Neither the Bill of Rights provisions in particular, nor FIPA in general, shed any light on this issue with respect to a claim based on the Bill of Rights provisions, although FIPA does provide that only a “franchisee” may maintain an action based on any other violation of FIPA.<sup>401</sup>

### *ii. Tie-In Requirements*

Franchisors often require franchisees to purchase goods or services from the franchisor or from designated “approved” suppliers. Indeed, it would be a rare franchise agreement that did not restrict a franchisee’s purchases of some goods or services. These provisions often serve the interests of the franchisor (and the franchise system as a whole) by ensuring quality and consistency throughout the system and by minimizing the franchisor’s costs of monitoring franchisee compliance with brand standards. Section 19.100.180(2)(b) of the Revised Code of Washington makes it unlawful for a franchisor to require a franchisee to purchase goods or services from approved sources of supply unless the franchisor can prove “that such restrictive purchasing agreements are reasonably necessary for a lawful purpose justified on business grounds, and do not substantially affect competition.”<sup>402</sup>

Given the importance and prevalence of restrictive purchasing requirements in virtually all franchise systems,<sup>403</sup> this provision of the Bill of Rights would likely be the subject of considerable controversy if the validity of any purchasing restriction turned on something as vague and ambiguous as whether the restriction is “reasonably necessary” or furthers justifiable “business grounds.” However, the provision proscribes only purchasing restrictions that “substantially affect competition” and directs that the provision be interpreted in a manner consistent with the federal antitrust laws.<sup>404</sup> In short, the clear intent of this section is to limit its scope only to a restrictive purchasing requirement that

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400. See generally, Jon S. Swierzewski, *Standing in Franchise Disputes: Check the Invitations, Not Every Party Gets Inside*, 26 FRANCHISE L.J. 107, 111–12 (2007) (“Franchisee associations rarely, if ever, can satisfy the [associational standing] requirements [set forth by the United States Supreme Court].”); see also William B. Steele, III & A. Darby Dickerson, *Standing Issues Related to Franchisee Associations*, 12 FRANCHISE L.J. 99, 101–02 (1993).

401. WASH. REV. CODE § 19.100.190(2) (2008). Cf. *Ward Enters., Inc. v. Bang & Olufsen Am., Bus. Franchise Guide (CCH) ¶ 12,735* (N.D. Ill. Dec. 2, 2003).

402. The provision expressly exempts any initial inventory purchased by the franchisee. WASH. REV. CODE § 19.100.190(2).

403. See Warren S. Grimes, *Market Definition in Franchise Antitrust Claims: Relational Market Power and the Franchisor’s Conflict of Interest*, 67 ANTITRUST L.J. 243, 246 (1999) (“[F]ranchisors commonly impose sourcing controls . . . as a means to maintain uniform quality control and the good will and efficiency of the franchise system.”).

404. WASH. REV. CODE § 19.100.180.

would constitute an illegal tie-in under either section 1 of the Sherman Act<sup>405</sup> or section 3 of the Clayton Act.<sup>406</sup> As Professor Chisum noted, “since the legislative intent is to avoid creation of differing state and federal standards on the legality of franchise tying agreements, section 18(2)(b) will have little impact on supply restrictions.”<sup>407</sup>

An essential element of a tying claim under federal antitrust law is that the seller have sufficient market power in one market—the market for the tying product—to restrain competition in a second market—the market for the tied product.<sup>408</sup> “[T]he essence of illegality in tying agreements is . . . [the fact that] a seller exploits his dominant position in one market to expand his empire into the next.”<sup>409</sup> When FIPA was adopted, cases such as the Ninth Circuit’s decision in *Siegal v. Chicken Delight, Inc.*, suggested that the owner of a trademark had sufficient market power through its trademark to support a finding of market power in the tying product.<sup>410</sup> In the years since FIPA’s adoption, that position has lost any validity.<sup>411</sup> Especially since the Supreme Court’s holding in *Eastman Kodak Co. v. Image Technical Services*,<sup>412</sup> and at least where the franchisee had notice of any restrictive purchasing requirements before entering into the franchise agreement,<sup>413</sup> courts have generally required proof of the franchisor’s market power before the parties contracted.<sup>414</sup> Few franchisors have so dominant a position in their industry (let alone if the franchisee’s choice includes other franchise opportunities) to satisfy the requisite market power in the tying product; consequently, this requirement has generally doomed franchisee tying claims.<sup>415</sup>

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405. 15 U.S.C. § 1 (2006).

406. *Id.* § 17.

407. Chisum, *supra* note 1, at 372.

408. See generally Benjamin Klein, *Market Power in Franchise Cases in the Wake of Kodak: Applying Post-Contract Hold Up Analysis to Vertical Relationships*, 67 ANTITRUST L.J. 283 (1999); see also Allan P. Hillman, *Franchise Tying Claims: Revolution or Just a “Kodak Moment?”*, 21 FRANCHISE L.J. 1 (2001).

409. *Times-Picayune Publ’g Co. v. United States*, 345 U.S. 594, 611 (1953).

410. 448 F.2d 43, 49–50 (9th Cir. 1971).

411. *Thirty Years of Franchising*, *supra* note 398, at 85–87 (stating that subsequent court decisions “for all practical purposes [have] sounded the death knell for tying claims in business format franchises”); see also Killion, *supra* note 37, at 26 (“[A] court under the prevailing law today would throw out the case on summary judgment given Chicken Delight’s lack of economic power in the tying product market.”).

412. 504 U.S. 451 (1992).

413. See Steven B. Feirman, *The Legality of Rebates from Suppliers*, 23 FRANCHISE L.J. 71, 77 (2003).

414. See Klein, *supra* note 408, at 283–84; see also Janet L. McDavid & Richard M. Steuer, *The Revival Of Franchise Antitrust Claims*, 67 ANTITRUST L.J. 209, 221 (1999).

415. See, e.g., *Maris Distrib. Co. v. Anheuser-Busch, Inc.*, 302 F.3d 1207, 1222 (11th Cir. 2002) (holding that the fact that Anheuser-Busch had power under its contract over many aspects of

### iii. Discrimination

The Franchisee Bill of Rights makes it unlawful for a franchisor to “discriminate between franchisees in the charges offered or made for royalties, goods, services, equipment, rentals, advertising service, or in any other business dealing.”<sup>416</sup> But the anti-discrimination provision does not apply if the franchisor shows that the disparate treatment is (1) reasonable; (2) based on franchises granted at materially different times; (3) reasonably related to such differences in times or based on other proper and justifiable distinctions considering the purposes of FIPA; and (4) not arbitrary.<sup>417</sup> The anti-discrimination provision does not, however, prevent a franchisor from negotiating changes to a franchise offering with a franchisee.<sup>418</sup> As amended in 1991, FIPA specifically authorizes a franchisor to negotiate the terms of a franchise, provided that the negotiation is done “at the initiative of the franchisee.”<sup>419</sup>

The provision’s legislative history suggests that it was “founded on the Robinson-Patman Act.”<sup>420</sup> FIPA’s provision is clearly broader than the Robinson-Patman Act in one respect: that Act deals only with the discriminatory pricing of “commodities.”<sup>421</sup> FIPA’s anti-discrimination provision, on the other hand, covers the prices charged by the franchisor, as well as the discriminatory enforcement of franchisee obligations, or other disparate treatment of franchisees. However, the reference to the Robinson-Patman Act helps clarify the statute’s reference to “proper and justifiable distinctions considering the purposes” of FIPA.<sup>422</sup> Because the Robinson-Patman Act is an antitrust law concerned with protecting competition, price differences under the Act are not unlawful if the favored and disfavored buyers do not compete for the same customers;

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its distributor’s operations “reveals little about the issue of whether [it] had market power in the broader, relevant market for the purchase and sale of equity ownership interests in beer distributorships”); *Queen City Pizza, Inc. v. Domino’s Pizza, Inc.*, 124 F.3d 430, 443 (3d Cir. 1997) (“[W]here the defendant’s ‘power’ to ‘force’ plaintiffs to purchase the alleged tying product stems not from the market, but from plaintiffs’ contractual agreement to purchase the tying product, no claim will lie.”). See generally Klein, *supra* note 408.

416. WASH. REV. CODE § 19.100.180(2)(c) (2008).

417. *Id.*

418. *Id.* § 19.100.184.

419. *Id.* See discussion *supra* Part III.C for more information about the 1991 amendments to FIPA.

420. Fletcher, *supra* note 22, at App. I, 7.

421. 15 U.S.C. § 13 (2006). Section 2(a) of the Robinson-Patman Act applies only to the sale of “commodities” and then only when the favored and disfavored purchasers buy commodities that are “of like grade and quality.” Other provisions of the Act cover discriminatory offers of certain services or price concessions for buyers that provide certain services. However, these provisions refer to such services or concessions only when offered in connection with the sale of a commodity or a product. See generally 14 HERBERT HOVENKAMP, ANTITRUST LAW ¶ 2314, 37 (2d ed. 2006).

422. WASH. REV. CODE § 19.100.180(2)(c).

thus, a disfavored buyer cannot have suffered competitive injury if it has not lost business to the favored buyer.<sup>423</sup> To the extent that FIPA draws upon federal law to define when disparate treatment is or is not “proper and justifiable,” this suggests that a franchisor’s disparate treatment of any two franchisees is “proper and justifiable” if the two franchisees do not actually compete with each other for customers. Thus, for example, a franchisor could legitimately charge a Seattle franchisee more for yogurt mix than the price it charges to a Spokane franchisee, given that the two franchisees do not compete and there is no competitive injury resulting from the disparate pricing. However, no court has decided this issue.<sup>424</sup>

Several cases have considered what other factors may justify discrimination. In *Armstrong v. Taco Time International, Inc.*,<sup>425</sup> the court held that a franchisor did not violate FIPA’s antidiscrimination provision by enforcing a post-term noncompetition covenant because the covenant, as amended, was reasonable, and the covenants applicable to other franchisees were part of franchise agreements executed during different time periods.<sup>426</sup> In *Precision Enterprises, Inc. v. Precision Tune, Inc.*, the

423. See *Fed. Trade Comm’n v. Morton Salt Co.*, 334 U.S. 37, 47 (1948) (holding that the Robinson-Patman Act prohibits charging different prices to “competing purchasers” where there is a reasonable possibility the discrimination may have an effect upon competition); see also *Volvo Trucks N. Am., Inc. v. Reeder-Simco GMC, Inc.*, 546 U.S. 164, 176–78 (2006) (holding that there can be no violation of the Robinson-Patman Act where favored and disfavored buyers do not compete head-to-head for same customer or where disfavored buyer cannot show it lost business to the favored buyer); *Perkasie Indus. Corp. v. Advance Transformer, Inc.*, 1992-2 Trade Cases ¶ 70,046, 69,165 (E.D. Pa. Oct. 8, 1992) (“If the plaintiff is able to show that a competitive relationship existed between themselves and the favored purchasers, Courts are likely to find that a substantial price difference is anti-competitive and thus a violation of [the Robinson-Patman Act].”), *aff’d*, 19 F.3d 644 (3d Cir. 1994); 14 HOVENKAMP, *supra* note 421, ¶ 2333b, 96–107 (“The disfavored purchaser must be injured in its ability to compete with the favored purchaser.”). FIPA seems also to expressly incorporate the Robinson-Patman concept that price discrimination is justifiable if the discriminatory sales are not reasonably contemporaneous. See *Vollrath Co. v. Sammi Corp.*, No. CV 85-820, 1989 WL 201632 (C.D. Cal. Dec. 20, 1989), *aff’d*, 9 F.3d 1455 (9th Cir. 1993). FIPA’s anti-discrimination provision expressly provides that discriminatory treatment may be justified if it is “based on franchises granted at materially different times.” WASH. REV. CODE § 19.100.180(2)(c).

424. In the authors’ experiences, at least one court, in an unpublished decision, dismissed franchisee discrimination claims where there was no competitive injury. Moreover, the same result may follow irrespective of the reach of FIPA’s antidiscrimination provision because such a claim is actionable only if the franchisee proves all the elements of a CPA claim. As noted, a CPA claim requires proof that the franchisee’s property or business has been injured by alleged wrongful conduct. See *Nelson v. Nat’l Fund Raising Consultants, Inc.*, 120 Wash. 2d 382, 393, 842 P.2d 473 (1992); see also discussion *supra* note 386. A franchisee that cannot show that the franchisor’s discriminatory actions caused any business losses presumably could not satisfy this essential element of a CPA claim.

425. 30 Wash. App. 538, 635 P.2d 1114 (1981).

426. *Id.* at 541–46. FIPA itself legitimizes discrimination between franchisees where their agreements were entered into at “materially different times.” WASH. REV. CODE § 19.100.180(2)(c) (2008). This is consistent with the requirements of the Robinson-Patman Act, which requires proof

franchisee alleged that the franchisor had violated the Bill of Rights discrimination provision by suing the plaintiff franchisee but electing not to sue other former franchisees for violating similar noncompetition clauses in their franchise agreements.<sup>427</sup> The court held that the franchisor had not violated FIPA's anti-discrimination provision because the franchisor's decision was a "rational business decision" based on the cost of bringing suit when compared with the possible recovery in such actions.<sup>428</sup> Similarly, in *Chico's Pizza Franchises, Inc. v. Sisemore*,<sup>429</sup> the court noted that a franchisor's disparate treatment of franchisees is not actionable if the franchisor can show that the disparate treatment is rationally and justifiably based on sound business practices.

#### *iv. Fair and Reasonable Pricing*

Section 19.100.180(2)(d) of the Revised Code of Washington prohibits a franchisor from selling, renting, or offering to sell to a franchisee "any product or service for more than a fair and reasonable price." The language is inexcusably vague. Only one reported case, *Nelson v. National Fundraising Consultants, Inc.*,<sup>430</sup> has considered this provision, and that decision provides little guidance as to when a product or service is sold "for more than a fair and reasonable price." In that case, the franchisee would order supplies through a designated supplier; that supplier would then bill the franchisor; and the franchisor would in turn bill the franchisee, adding a "standard" 20% mark-up from the supplier's invoice.<sup>431</sup> Affirming a determination that the franchisor had violated section 19.100.180(2)(d), the Washington Supreme Court indicated that any price charged in excess of a bona fide wholesale price constituted a violation of this provision, a point the franchisor essentially conceded by arguing that the amounts it invoiced the franchisee was both a price charged for the supplies *plus* a disguised royalty.<sup>432</sup>

The *Nelson* Court seemed to assume that a "fair and reasonable price" means a "bona fide wholesale price"—an approach suggested by

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that the discriminatory sales were simultaneous or reasonably contemporaneous. See, e.g., *Vollrath Co. v. Sammi Corp.*, No. CV 85-820, 1989 WL 201632 (C.D. Cal. Dec. 20, 1989), *aff'd*, 9 F.3d 1455 (9th Cir. 1993) (requiring reasonably contemporaneous sales).

427. *Bus. Franchise Guide* (CCH) ¶ 10,472 (W.D. Wash. Oct. 4, 1993).

428. *Id.*

429. 544 F. Supp. 248, 248-49 (E.D. Wash. 1981), *aff'd*, 685 F.2d 440 (9th Cir. 1982). The court did not reach the merits of the franchisee's discrimination claim, however, concluding that it would be unconstitutional to apply FIPA to a franchise that pre-dated the effective date of FIPA. *Id.* at 249-50.

430. 120 Wash. 2d 382, 842 P.2d 473 (1992).

431. *Id.* at 385.

432. *Id.* at 388.

Professor Chisum.<sup>433</sup> However, *Nelson* provides no guidance as to how a trial court should determine when a price exceeds a bona fide wholesale price. The answer to this question is not self-evident, even where the case centers on the sale of fungible goods for which there exists a well-established wholesale market. Moreover, even if a bona fide wholesale price is somewhat helpful in determining the reasonableness of prices for goods with established markets, it is worthless when the price in question relates to goods or services that have no market.<sup>434</sup> These are almost metaphysical questions when there is no wholesale market, such as for the sale of services or the sale of proprietary or unique goods.

There is another approach to this issue, one more consistent with the provision's scant legislative history. That history suggests that the legislature's intent in enacting the provision was to grant pricing flexibility to franchisors in light of changing economic and market fluctuations but to deny them the power to set prices arbitrarily.<sup>435</sup> This suggests that the legislature designed section 19.100.180(2)(d) not to appoint the courts as rate-making agencies charged with splitting the revenue pie between franchisor and franchisee under the guise of fixing a "fair and reasonable" price, but rather to protect franchisees from franchisors overreaching to set arbitrary prices.

Thus, the crux of the issue is the franchisor's exercise of discretion in setting the price, not the actual price itself. This makes perfect sense in the context of franchise agreements, which are almost universally long-term contracts—contracts which, by their very nature, make it impossible for the parties to set fixed prices for goods or services at the outset of the relationship.<sup>436</sup> Although the parties need flexibility in this type of relationship, this flexibility should not be read as an invitation by the franchisor to abuse its discretion in setting prices. From this perspec-

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433. See Chisum, *supra* note 1, at 372 n.421. Professor Chisum and the Court in *Nelson* relied on the definition of a franchise fee to reach this conclusion. Specifically, section 19.100.010(12)(a) of the Revised Code of Washington excludes "the purchase or agreement to purchase goods at a bona fide wholesale price" from the definition of a franchise fee. Consequently, they conclude that the reasonable price provision contained in section 19.100.180(2)(d) cannot be circumvented by a franchisor merely by secreting franchise fees as markups on required product pricing. This is all well and good when applied to the purchase of products that are otherwise available in the marketplace; but, the fair and reasonable price provision in the Franchisee Bill of Rights is broader than common marketplace products, applying to any product or service. *Id.*

434. See discussion *supra* note 433.

435. Fletcher, *supra* note 22, at 234 ("Requiring fair and reasonable prices on all charges will give the franchisors flexibility for necessary price fluctuations but deny to them the current power of unilateral price changes.")

436. See Robert E. Scott, *Conflict & Cooperation in Long-Term Contracts*, 75 CAL. L. REV. 2005, 2013 (1987) ("Many of the contingencies that affect supply and demand conditions over the life of a long-term contract are too complex and uncertain for the parties to predict their likelihood or scope.")

tive, the focus of the fair and reasonable price provision should therefore be on the manner in which prices are set, rather than on some abstract assessment of the “fairness” of a price once set.

This is exactly the focus of section 305, article 2 of the Uniform Commercial Code (UCC).<sup>437</sup> That provision, which addresses contracts with open price terms, mandates that “[a] price to be fixed by the seller or by the buyer means a price for him to fix in good faith.”<sup>438</sup> This suggests that a price set in good faith in compliance with section 305(2) of the UCC is a “fair and reasonable price” under FIPA’s Bill of Rights.

The question, then, is what qualifies as “good faith.” Standing alone, the term provides little guidance. But “good faith” has been codified in the UCC to mean both “honesty in fact” and the observance of commercially reasonable standards.<sup>439</sup> A franchisor that sets a price in disregard of commercially reasonable standards violates the good faith requirement. Similarly, even if the price charged is commercially reasonable on its face, a franchisor that sets a price with the intent to drive the franchisee out of business has failed to satisfy the “honesty in fact” good faith requirement.

Although these terms have their own convoluted history of interpretation by the courts, the test should be relatively simple.<sup>440</sup> If the parties intended that the price charged by the franchisor would be the posted price (the price available to all franchisees on the date offered—which may already be required by FIPA’s non-discrimination provision),<sup>441</sup> then the franchisee has the burden of showing that the price is commercially unreasonable.<sup>442</sup> If the franchisee cannot make that showing, the franchisee can still show a lack of good faith on the part of the franchi-

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437. U.C.C. § 2-305 (1977).

438. *Id.*

439. *Id.* § 2-103(1)(b).

440. See generally Berry, Byers & Oates, *supra* note 374, for a discussion on good faith pricing in open price term arrangements.

441. WASH. REV. CODE. § 19.100.180(2)(c) (2008).

442. Berry, Byers & Oates, *supra* note 374, at 47. To satisfy its burden, the plaintiff must show that the price is not facially commercially reasonable: i.e., present evidence showing that 1) the seller charged different prices to different buyers at the same time; or 2) the price charged is not within the range of prices charged by the seller’s competitors in the same market. *Id.* at 48. See also *Wayman v. Amoco Oil Co.* 923 F. Supp. 1322, 1347 (D. Kan. 1996) (entering summary judgment because “plaintiffs do not allege that they were treated differently than other similarly situated dealers.”); *Wilson v. Amerada Hess Corp.*, 773 A.2d 1121, 1132 (N.J. 2001) (reversing summary judgment when the plaintiffs demonstrated that the prices set were outside the range of prices charged by similarly situated competitors). The franchisee must also demonstrate that the franchisor set the prices without regard to reasonable commercial standards in the trade. Berry, Byers & Oates, *supra* note 374, at 48. Without this additional evidence, a fact-finder has no standard of comparison to determine whether the franchisor had a legitimate, lawful reason for charging different effective prices. *Id.*

sor, but the burden of proof is significantly higher: clear and convincing proof that the franchisor has a malevolent intent to drive the franchisee out of business.<sup>443</sup> If the franchisee satisfies either burden, then the price set by the franchisor is unreasonable and is a violation of the Franchisee Bill of Rights.

v. "Kickbacks"

Franchisors often receive payments from suppliers based on purchases of goods or services by the franchisor or its franchisees.<sup>444</sup> And, although franchisees have challenged a franchisor's right to retain payments obtained from franchisee suppliers, these challenges have mostly been unsuccessful.<sup>445</sup> The Franchisee Bill of Rights confronts this issue by making it unlawful for a franchisor to "obtain money, goods, services, anything of value, or any other benefit from any other person with whom the franchisee does business on account of such business unless such benefit is disclosed to the franchisee."<sup>446</sup> As originally drafted, this provision prohibited third party supplier rebates by requiring that any payment received by the franchisor from a supplier be "promptly accounted for and transmitted to the franchisee."<sup>447</sup> The legislature replaced this provision with the limited requirement of disclosure before the Act became effective.<sup>448</sup>

Accordingly, this provision deals only with the disclosure of any sums the franchisor may receive from franchisee suppliers. While all of FIPA's other Bill of Rights provisions address a franchisor's and franchisee's post-sale relationship, this provision requires a pre-sale disclosure of amounts a franchisor receives from designated or required suppliers.<sup>449</sup> In the only case to consider this provision, *Nelson v. National Fundraising Consultants, Inc.*, the Court noted that "[d]isclosure of a contract's

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443. Berry, Byers & Oates, *supra* note 374, at 50. Absent the proverbial "smoking gun" memorandum, it is unlikely that a franchisee would be able to demonstrate that the franchisor is actively trying to drive the franchisee out of business.

444. See generally Feirman, *supra* note 413.

445. *Dunkin' Donuts, Inc. v. N.A.S.T., Inc.*, No. 02 C 1272, 2003 WL 1877626 (N.D. Ill. Apr. 11, 2003); *Little Caesar Enters., Inc. v. Smith*, 895 F. Supp. 884, 900 (E.D. Mich. 1995); *Zahava Group, Inc. v. Togo's Eateries, Inc.*, No. GIC768212, 2003 WL 22073310 (Cal. App. Dep't Super. Ct. May 9, 2003).

446. WASH. REV. CODE § 19.100.180(2)(e) (2008).

447. Franchise Investment Protection Act, ch. 252, § 18(2)(e), 1971 Wash. Sess. Laws, 1st Ex. Sess. 1128, 1139.

448. An Act Relating to Franchises, ch. 116, sec. 10, § 18, 1972 Wash. Sess. Laws, 2d Ex. Sess. 259, 273.

449. *Nelson v. Nat'l Fund Raising Consultants, Inc.*, 120 Wash. 2d 382, 390-92, 842 P.2d 473 (1992).

terms, to be meaningful, must occur before contract formation, not after the parties have become contractually bound.<sup>450</sup>

Since the adoption of FIPA, the information required to be disclosed under section 19.100.180(2)(e) of the Revised Code of Washington became a required item of disclosure under Item 8 of NASAA's Uniform Franchise Offering Circular and, more recently, has been codified in Item 8 of the FTC's Franchise Disclosure Rule.<sup>451</sup> Due to these changes, section 19.100.180(2)(e) appears to add no pre-sale requirements beyond those imposed by the franchise disclosure rules.<sup>452</sup>

#### *vi. Exclusive Territories*

Section 19.100.180(2)(f) of the Revised Code of Washington prohibits a franchisor from granting competitive franchises or from directly competing in any exclusive territories specifically granted to a franchisee. As originally enacted, the provision required franchisors to grant exclusive territories.<sup>453</sup> The provision was amended before its effective date, and now only prohibits franchisors from competing directly with

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450. *Id.* at 391. It should be noted that on its face, FIPA would appear to require disclosure of benefits throughout the term of the franchise. WASH. REV. CODE § 19.100.180(2)(e) (making it an unfair or deceptive act for a franchisor to "obtain money, goods, services, anything of value or any other benefit from any other person with whom the franchisee does business on account of such business unless such benefit is disclosed to the franchisee"). The statute does not appear to be limited to arrangements in existence before the parties execute the franchise agreement. But it is difficult to imagine what injury might accrue as a result of any post-sale disclosure obligation, and most courts have typically held that a franchisor has no general duty to disclose after the parties have contracted. *See Williams v. Dresser Indus., Inc.*, 120 F.3d 1163, 1174 (11th Cir. 1997), *reh'g denied*, 136 F.3d 1333 (11th Cir. 1998); *Barnes v. Burger King Corp.*, 932 F. Supp. 1420, 1430 (S.D. Fla. 1996) (holding that a franchisor holds no duty of disclosure because "[i]t is well-settled . . . that a franchisor is not in a fiduciary relationship with a franchisee").

451. 16 C.F.R. § 436.5(h) (2007). Item 8 of the FTC Franchise Rule requires, among other things, that the franchisor disclose the existence of any obligation the franchisee has to purchase from designated suppliers, any "interest" the franchisor may have in any such supplier, and any revenues or other benefits the franchisor or any affiliate receives from required purchases from the franchisor, its affiliates, or a third-party supplier.

452. In his commentary following adoption of FIPA, Professor Chisum speculated that this provision may require post-sale disclosures of amounts received during the franchise term. Chisum, *supra* note 1, at 372. On its face, the provision would suggest as much, since it is part of statutory provision governing the "relation between the franchisor or subfranchisor and the franchisees." WASH. REV. CODE § 19.100.180 ("Without limiting the other provisions of this chapter, the following specific rights and prohibitions shall govern the relation between the franchisor or subfranchisor and the franchisees.") Indeed, though the Court in *Nelson* held that the provision applies to a franchisor's presale disclosures, it is very difficult to read the section as applying to anything other than the post-sale relationship between a franchisor and its franchisees. *See* 120 Wash. 2d at 390-92. At the same time, however, it is very difficult to imagine what damage or injuries would flow from a franchisor's failure to make post-sale disclosures.

453. Franchise Investment Protection Act, ch. 252, § 18(2)(f), 1971 Wash. Sess. Laws, 1st Ex. Sess. 1128, 1139 (making it an unfair or deceptive act for franchisor to compete with the franchisee or grant competitive franchises to others in the franchisee's relevant market).

franchisees or from granting franchises to a franchisee's competitors, where the franchise agreement explicitly grants an exclusive territory to the franchisee.<sup>454</sup> This amendment clearly implies that a franchisor is perfectly free to compete against a franchisee unless the parties' franchise agreement grants territorial protection to the franchisee. The court's holding in *Goodyear Tire & Rubber Co. v. Whiteman Tire, Inc.*<sup>455</sup> is consistent with this view. In that case, the court found that a manufacturer did not violate a duty of good faith by operating its own retail facility in competition with the dealer because the dealership agreement did not reserve an exclusive territory for the dealer and, indeed, expressly reserved to the manufacturer the right to compete in the dealer's trade area.<sup>456</sup>

### vii. Anti-Waiver

FIPA contains two anti-waiver provisions. The first, found in section 19.100.220(2) of the Revised Code of Washington, outlaws any "agreement, condition, stipulation or provision, including a choice of law provision,<sup>457</sup> purporting to bind any person to waive compliance with" FIPA.<sup>458</sup> The provision further provides, however, that a release or waiver executed by one person comports with the provision if it represents a negotiated settlement of a "bona fide dispute" between a franchisor and a franchisee arising after the franchise agreement has taken effect and in which the franchisee is represented by independent counsel.<sup>459</sup>

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454. An Act Relating to Franchises, ch. 116, sec. 10, § 18, 1972 Wash. Sess. Laws, 2d Ex. Sess. 259, 272 (making it an unfair or deceptive act for franchisor to compete with the franchisee or grant competitive franchises to others in the exclusive territory area specified in the franchisee's franchise agreement).

455. 86 Wash. App. 732, 935 P.2d 628 (1997).

456. *Id.* at 738-41.

457. Section 19.100.220 was amended in 1991 to specifically identify a choice of law provision as an item that is prohibited from waiver agreements. An Act Relating to Franchise Investment Protection, ch. 226, § 13, 1991 Wash. Sess. Laws 1123, 1139. The specific identification of a choice of law provision as the type of waiver prohibited by the statute suggests a legislative intent not to exclude other types of waiver (such as an arbitration provision) as the type of provision encompassed within the anti-waiver provision. See, e.g., *Mgmt. Recruiters Int'l, Inc. v. Bloor*, 129 F.3d 851, 855 (6th Cir. 1997) (holding that FIPA did not preclude a franchisor from stipulating to arbitration in a venue other than Washington, notwithstanding the Washington Securities Division's contrary Interpretive Statement, FIS-4); see FIS-4, *supra* note 262. "[D]ifficult Supremacy Clause issues likely would be implicated by a state-law requirement invalidating arbitration agreements that provide for arbitration outside Washington." *Mgmt. Recruiters Int'l, Inc.*, 129 F.3d at 855.

458. WASH. REV. CODE § 19.100.220(2) (2008).

459. *Id.* Read literally, the provision would appear to invalidate any release of a claim under FIPA if the franchisee was not actually "represented by independent legal counsel" when the release was executed. Requiring actual representation rather than only an opportunity to retain counsel is inconsistent with the interpretation applied to similar state and federal statutes, as well as case law consistently upholding such releases. See discussion *infra* notes 460-463. Moreover, such a strict

Yet the procedure outlined in the second half of section 19.100.220(2) is not the exclusive means for obtaining a valid release of FIPA claims.<sup>460</sup>

The second anti-waiver provision is contained in section 19.100.180(2)(g). This provision makes it unlawful to require a franchisee to assent to a release, assignment, novation, or waiver that would relieve any person from liability imposed by FIPA, except as otherwise permitted by section 19.100.220. The Securities Division stated in an Interpretive Statement that FIPA's anti-waiver provisions preclude a franchisor from requiring a franchisee to execute a release of claims arising under FIPA as a condition to approving a franchise transfer; however, a release of all other claims is permissible.<sup>461</sup> Releases executed in conjunction with the settlement of bona fide disputes are common, and franchise statutes in a number of other states have anti-waiver provisions identical or similar to Washington's provision.<sup>462</sup> Courts have consistently upheld the enforceability of those releases in the franchise context.<sup>463</sup>

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reading of the language has the curious effect of making it more difficult for franchisees to obtain a beneficial settlement. Unless the franchisee has incurred the additional expense of hiring an attorney, the franchisor has no incentive to settle a bona fide franchisee claim. Many franchisees do not have the financial wherewithal to take such a step. The more sensible construction of this provision is to require the franchisee to have the reasonable *opportunity* to retain counsel. This construction would also be consistent with the legislature's intent when it added the provision in 1991—to make it *easier* for franchisors and franchisees to settle disputes. *Cf.* Chisum, *supra* note 1, at 375–76.

460. To the contrary, the second sentence of section 19.100.220(2) is more appropriately viewed as a “safe harbor” provision that guarantees that compliant franchisors are protected against future claims. The language of the second sentence merely identifies one way of avoiding the prohibition against waiver, noting that a safe harbor release “is not an agreement prohibited by this subsection.” *Id.* The sentence does not state that the safe harbor release is “an exception” or “a proviso” to the prohibition against waivers. *Id.*

461. *See* FIS-2, *supra* note 275 (“The requirement of a release by the franchise [sic] to the franchisor is acceptable so long as it does not include a release of the franchisee’s claims under the Washington Franchise Investment Protection Act.”). Thus, a release of any non-FIPA claims is not prohibited.

462. California Franchise Relations Act, CAL. BUS. & PROF. CODE § 20010 (West 2008); Connecticut Franchise Act, CONN. GEN. STAT. § 42-133f (2008); Hawaii Franchise Investment Law, HAW. REV. STAT. § 482E-6(2) (2008); Indiana Deceptive Franchise Practices Act, IND. CODE § 23-2-2.7-1(5) (2008); Michigan Franchise Investment Law, MICH. COMP. LAWS § 445.1527(b) (2008); MINN. R. 2860.4400(D) (2008); Nebraska Franchise Practices Act, NEB. REV. STAT. §§ 87–406(1) (2008); New Jersey Franchise Practices Act, N.J. STAT. ANN. § 56:10-7(a) (2008); N.Y. GEN. BUS. LAW § 687(5) (McKinney 2008); Wisconsin Franchise Investment Law, WISC. STAT. § 553.76 (2008). The anti-waiver provisions of state franchise statutes are all modeled upon the anti-waiver provisions of the federal securities statutes. *See* 15 U.S.C. § 78cc(a) (2006). Federal courts have uniformly held that this anti-waiver provision does not invalidate the negotiated release of known and existing claims. *See* Petro-Ventures, Inc. v. Takessian, 967 F.2d 1337, 1342 (9th Cir. 1992); Korn v. Franchard Corp., 388 F. Supp. 1326, 1329 (S.D.N.Y. 1975); Mittendorf v. J.R. Williston & Beane, Inc., 372 F. Supp. 821, 835 (S.D.N.Y. 1974).

463. *See, e.g.,* Vaughn v. Gen. Foods Corp., 797 F.2d 1403, 1416 (7th Cir. 1986), *cert. denied*, 479 U.S. 1087 (1987). Section 19.100.220 simply does not prohibit releases of known and existing claims arising after the franchise agreement has taken effect. The language for the provision is taken

For example, in *Corp v. Atlantic Richfield Co.*, the court affirmed the dismissal of a franchisee's claims based on the existence of a release executed when the plaintiff-franchisee transferred his franchise to a third party.<sup>464</sup> In upholding the release, the court noted that releases are contracts governed by the same principles as any other contract but failed to even discuss the anti-waiver provision of FIPA.<sup>465</sup> Similarly, in *Harb v. Norrell Services, Inc.*, the court held that FIPA's anti-waiver provision applied to a release of claims and did not apply to pre-sale disclaimers in the offering circular or franchise agreement.<sup>466</sup>

The anti-waiver provisions are best understood as prohibitions against prospective waivers.<sup>467</sup> They provide a valuable tool for preventing franchisors from extracting advance liability waivers from franchisees prior to entering into the franchise agreement.

#### *viii. Unreasonable Standards of Conduct*

Franchisees often describe in some detail how section 19.100.180(2)(h) of the Revised Code of Washington prohibits a franchisor from imposing on any franchisee "by contract, rule, or regulation" any "standard of conduct" unless the franchisor can prove that such standard is both reasonable and necessary. Yet, currently no decisions have considered this provision.<sup>468</sup>

To a large degree, the franchise model is based upon presenting a uniform image and consistent services and product offerings across a network of independently owned and operated business units.<sup>469</sup> Consequently, franchisors generally expect that a consumer's experience should not vary from region to region or unit to unit, irrespective of who is operating each unit.<sup>470</sup> Most franchisees recognize the importance of consistency and uniformity; yet, in perhaps all systems there are free-riders who save costs by offering substandard services or products, while

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nearly verbatim from federal securities laws, which have been never been construed to prohibit the release of known and existing claims. See 15 U.S.C. § 78cc(a) (2006).

464. 67 Wash. App. 520, 837 P.2d 1030 (1992), *rev'd on other grounds*, 122 Wash. 2d 574, 860 P.2d 1015 (1993).

465. 67 Wash. App. at 532.

466. Bus. Franchise Guide (CCH) ¶ 10,185 (W.D. Wash. Jan. 29, 1993).

467. See Chisum, *supra* note 1, at 375-76.

468. Shortly after FIPA's enactment, Chisum declared, in perhaps an ironic understatement, "This section could prove troublesome in its operation." *Id.* Chisum, *supra* note 1, at 376. The provision's patent ambiguity may partly explain why it has not been the subject of more litigation.

469. See 1 W. MICHAEL GARNER, FRANCHISE & DISTRIB. LAW & PRACTICE § 1:1 (1990).

470. "KFC chicken should taste the same and be served with the same friendly service regardless of whether it is purchased in Tiananmen Square in Beijing, China, or in Louisville, Kentucky." JEFFREY L. BRADACH, FRANCHISE ORGANIZATIONS 16-17 (1998) (quoting Gregory Reynolds, then vice president of public affairs at KFC).

enjoying the benefits of the system's good will built through the efforts of the franchisor and other franchisees.<sup>471</sup> Franchisees often complain to the franchisor about underperforming outlets and request that the franchisor intervene because franchisees know how a bad experience by a customer in one location can have an adverse impact throughout the entire franchise system and, ultimately, on them.<sup>472</sup>

The uniformity found within a franchise system does not occur by happenstance. Typically, franchisors specify performance requirements in their franchise agreements and operations manuals that franchisees are expected to follow. These standards may encompass virtually every detail of a franchised unit's operation, covering, for instance, the hours of operation, ingredients to be used in a hamburger, the decor and layout of the franchised unit, the uniforms that employees wear, and the items that may and may not be included on the menu. These standards are often specified in some detail to avoid confusion and to limit the franchisee's discretion regarding the products and services it can use.<sup>473</sup> These operational standards are the subject of regulation in section 19.100.180(2)(h).

System standards of conduct are unlikely to benefit all franchisees equally. Indeed, any standard, as applied to any particular franchisee or group of franchisees, may entail greater cost than benefit. A requirement that a franchisee feature the chain's signature frozen dessert is not apt to benefit franchisees in Fairbanks in the same way it may benefit franchisees in Houston. While there are no cases construing this provision of FIPA, presumably a "standard of conduct" is not "reasonable and necessary" simply because a particular franchisee, or class of franchisees, does not benefit from a challenged standard, at least where the challenged rule or standard of conduct benefits the system as a whole or makes business sense from the perspective of the overall system. Courts have generally

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471. See, e.g., Richard E. Caves & William F. Murphy, II, *Franchising: Firms, Markets, and Intangible Assets*, 42 S. ECON. J. 572, 577 (1976) (describing the free-rider problem as follows: "A franchisee who reduces the quality of the good or service he offers for a given price might increase his own profits, yet by disappointing buyers' expectations he could reduce by a greater amount the net returns to the common intangible goodwill asset maintained by the franchisor and used jointly by his other franchisees.").

472. See, e.g., Jeffrey A. Tannenbaum & Stephanie N. Mehta, *Bias at Single Store Can Taint Franchise Chain's Image*, WALL ST. J., Mar. 6, 1997, at B2 (mentioning the case of Fernando Galaviz, a Hispanic man who said he refused to book any travel with one national hotel chain because he and some colleagues "experienced specific racist attitudes" at one of the chain's hotels. Although Galaviz said he realized that he might be penalizing nonracist franchisees in the process, he felt that he was justified in doing this as "[t]hey're all part of the same family.").

473. Although the level of detail in describing system standards does not remove the incentive any individual franchisee may have to reduce quality for private gain, "it does limit the franchisee's discretion and provides grounds for termination if the franchisee behaves opportunistically." Roger D. Blair & Francine Lafontaine, *Understanding the Economics of Franchising and the Laws that Regulate It*, 26 FRANCHISE L.J. 55, 61 (2006).

been reluctant to second guess business decisions,<sup>474</sup> and it seems highly unlikely that section 19.100.180(2)(h) was intended to undercut a franchisor's business judgment in establishing standards for its franchise system.

#### *ix. Refusal to Renew*

As originally enacted, section 19.100.180(2)(i) of the Revised Code of Washington required franchisors to offer a new franchise upon expiration on the "terms and standards then equally applicable to all franchisees."<sup>475</sup> The provision was changed to its current form even before FIPA's effective date.<sup>476</sup> As amended, this provision grants no renewal right, and instead allows a franchisor to refuse to renew a franchise for any reason.<sup>477</sup> Under this provision, a refusal to renew is a refusal by the franchisor to offer a new franchise at the expiration of the term.<sup>478</sup> The franchise offered on renewal may be significantly differ-

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474. This reluctance to second-guess a manager's decisions is seen in the Business Judgment Rule. The Business Judgment Rule is a common law doctrine but it also appears in various corporate statutes. Judicial reluctance to second-guess decisions by managers can be traced back 250 years in England to *Charitable Corp. v. Sutton*, 2 Atk. 400, 404 (1742), and in the United States, to 1829, with *Percy v. Millandon*, 8 Mart. (n.s.) 68 (La. 1829). The common law rule applies to management generally and not just corporate directors. See, e.g., *Thomle v. Soundview Pulp Co.*, 181 Wash. 1, 24, 42 P.2d 19 (1935); *Para-Medical Leasing, Inc. v. Hangen*, 48 Wash. App. 389, 395, 739 P.2d 717 (1987).

475. Franchise Investment Protection Act, ch. 252, § 18(2)(i), 1971 Wash. Sess. Laws, 1st Ex. Sess. 1128, 1139.

476. An Act Relating to Franchises, ch. 116, sec. 10, § 18, 1972 Wash. Sess. Laws, 2d Ex. Sess. 259, 273.

477. *Id.* See also *Thompson v. Atlantic Richfield Co.*, 663 F. Supp. 206, 208 (W.D. Wash. 1986), *reconsideration denied*, Bus. Franchise Guide (CCH) ¶ 9080 (W.D. Wash. June 17, 1987); *Corp v. Atlantic Richfield Co.*, 122 Wash. 2d 574, 580-81, 860 P.2d 1015 (1993); *Chisum*, *supra* note 1, at 379 n.449. It is not uncommon for franchise agreements to grant certain contractual renewal rights. A refusal to offer a new franchise on renewal in breach of these contractual renewal rights would, of course, give rise to a claim under the contract.

478. Nonrenewal is the refusal to offer a new agreement at the end of the term, as opposed to termination, which is the cancellation of the franchise agreement during the term. While most franchise agreements have a definite term, in the unusual case where the agreement lacks a term, the franchise is generally terminable at will upon reasonable notice. See *Alpha Distrib. Co. of Cal., Inc. v. Jack Daniel Distillery, Lem Motlow, Prop., Inc.*, 454 F.2d 442, 448-49 (9th Cir. 1972); *Clausen & Sons, Inc. v. Theo. Hamm Brewing Co.*, 395 F.2d 388, 390-91 (8th Cir. 1968); *Lund v. Arbonne Int'l, Inc.*, 887 P.2d 817, 820 (Or. App. 1994); *cf. Puretest Ice Cream, Inc. v. Kraft, Inc.*, 806 F.2d 323, 324 (1st Cir. 1986); *Scanlan v. Anheuser-Busch, Inc.*, 388 F.2d 918, 920 (9th Cir. 1968); *Robert Porter & Sons, Inc. v. Nat'l Distillers Prods. Co.*, 324 F.2d 202, 205 (10th Cir. 1963); *Kendall-Jackson Winery, Ltd., v. Branson*, 82 F. Supp.2d 844, 869 (N.D. Ill. 2000); *Randall v. Tradewell Stores, Inc.*, 21 Wash. 2d 742, 746, 153 P.2d 286 (1944); *Birkenwald Distrib. Co. v. Heublein, Inc.*, 55 Wash. App. 1, 6-7, 776 P.2d 721 (1989); *Kwik-Lok Corp. v. Pulse*, 41 Wash. App. 142, 148, 702 P.2d 1226 (1985); *Cromwell v. Gruber*, 7 Wash. App. 363, 366-68, 499 P.2d 1285 (1972). For franchise agreements without a specific term, FIPA's nonrenewal provision, not the termination provision, likely applies. At least one court has so held, though in an unpublished decision. See *Dr. Pepper/Seven Up, Inc. v. A&W Bottling, Inc.*, No. C03-365Z (W.D. Wash. Nov.

ent—and from the franchisee’s perspective more onerous—than the expiring franchise, but the fact that it is different or unfavorable is not a refusal to renew.<sup>479</sup>

While FIPA does not grant a renewal right, it does provide that upon nonrenewal the franchisor must repurchase at “fair market value” any of the franchisee’s inventory, supplies, equipment, and furnishings that were “purchased from the franchisor.”<sup>480</sup> The provision excludes from this repurchase obligation “personalized materials which have no value to the franchisor and inventory, supplies, equipment and furnishings not reasonably required in the conduct of the franchise business.”<sup>481</sup> Fair market value is not defined, but at least for inventory or supplies, this would generally be measured by the franchisee’s cost. The franchisor may also offset any amounts the franchisee may owe to the franchisor upon expiration.<sup>482</sup>

FIPA also requires a non-renewing franchisor to pay the franchisee for its “good will” unless the franchisor has given at least one year’s notice of nonrenewal and agrees in writing not to enforce any post-term covenant against competition contained in the franchise.<sup>483</sup> Good will is not defined by the statute, and it is a term that has a variable meaning.<sup>484</sup> Presumably, the “good will” for which the franchisor must pay is the franchisee’s good will, as distinct from any good will that is attributable

23, 2004) (Where alleged franchise contained no term and was terminable at will, putative franchisor complied with FIPA by providing one year’s notice of nonrenewal).

479. *Thompson*, Bus. Franchise Guide (CCH) ¶ 9080; *Corp.*, 122 Wash. at 585. Because of FIPA’s antidiscrimination provision, however, the franchise offered on renewal probably must be on the same terms as that being offered by the franchisor to similarly situated prospective franchisees.

480. WASH. REV. CODE § 19.100.180(2)(i) (2008).

481. *Id.*

482. *See id.*

483. *Id.*

484. *See, e.g., In re Marriage of Lukens*, 16 Wash. App. 481, 483–85, 558 P.2d 279 (1976) (defining good will as “a benefit or advantage ‘which is acquired by an establishment beyond the mere value of the capital, stock, funds or property employed therein, in consequence of the general public patronage and encouragement, which it receives from constant or habitual customers on account of its local position, or common celebrity, or reputation for skill or affluence, or punctuality, or from other accidental circumstances or necessities, or even from ancient partialities or prejudices” (quoting J. Story, PARTNERSHIP § 99 (3d ed. 1850))); *In re Marriage of Hall*, 103 Wash. 2d 236, 241, 246, 692 P.2d 175 (1984) (“Goodwill is a property or asset which usually supplements the earning capacity of another asset, a business or a profession.”). As distinct from earning capacity, which is “comprised of skill and education,” good will is instead composed of “such things as location, referrals, associations, reputation, trade name and office organization.” *Hall*, 103 Wash. 2d at 241; *see also Tele-Comm’ns, Inc. v. Comm’r of Internal Revenue Serv.*, 95 T.C. 495, 521 (1990) (Good will is “the expectancy that old customers will resort to the old place . . . . The essence of goodwill is the expectancy of continued patronage, for whatever reason.”); Treas. Reg. § 1.197-2(b)(1) (1960) (“Goodwill is the value of a trade or business attributable to the expectancy of continued customer patronage. This expectancy may be due to the name or reputation of a trade or business or any other factor.”).

to the franchisor's trademark or to the franchise system.<sup>485</sup> A franchisee's success may, in many instances, be the result of the franchisee's unique efforts, including in some instances, its skill in site selection, franchisee-specific marketing and advertising, and the franchisee's unique management skills.<sup>486</sup> In many instances, however, the good will—or excess profits generated by the franchised business—is attributable to the franchisor and not the franchisee. As one court has noted with regard to the calculation of the franchisee's good will of McDonald's franchises:

Customers patronize McDonald's restaurants because they know what they are going to get in terms of product, quality, service, and price from store to store. This is the direct result of the McDonald's system that requires specific standards of quality, service, and cleanliness as part of the franchise agreement. Certainly, the quality, consistency, and service that the system produces result in goodwill, but because of the structure of McDonald's, that goodwill inheres in the McDonald's trade name and trademarks.<sup>487</sup>

It is equally unclear if the payment for "good will" depends on whether the franchisee will continue to operate the same type of business after nonrenewal at the franchised location. Franchisors often control the real estate from which a franchisee operates its business. In such cases, a nonrenewal is tantamount to the end of the business, or at least means the former franchisee must start from scratch, securing and furnishing a new location and establishing a new business identity. Often, however, the nonrenewal of a franchise simply means the franchisee continues to operate the same business at the same location, doing no more than re-flagging the location from which it operates. This is common with franchises in the hotel, real estate brokerage, and gas station businesses. It is doubtful that the legislature intended a franchisor to pay "good will" calculated in a similar fashion to both the franchisee that continues to

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485. *Pappan Enters. v. Hardee's Food Sys.*, 143 F.3d 800, 806 (3d Cir. 1998); Clay A. Tillack & Mark E. Ashton, *Who Takes What: The Parties' Rights to Franchise Materials at the Relationship's End*, 28 *FRANCHISE L.J.* 88, 124 (2008).

486. Tillack & Ashton, *supra* note 485, at 124; *see also* *Hill v. Mobile Auto Trim, Inc.*, 725 S.W.2d 168, 171 (Tex. 1987).

487. *Canterbury v. Comm'r of Internal Revenue Serv.*, Bus. Franchise Guide (CCH) ¶ 10,089 (T.C. Aug. 17, 1992) (footnotes omitted). *See also* *Narumanchi v. Shell Oil Co.*, Bus. Franchise Guide (CCH) ¶ 8,720 (D. Conn. Dec. 10, 1986). In *Narumanchi*, Shell was not required to compensate dealer for good will under Connecticut petroleum franchise statute where, after adjustments for salaries to the dealer and the dealer's spouse and for interest on loans, the dealership did not turn a profit, and earnings were far below the industry average during the period. *Id.* In short, the dealership "had a negative good will." *Id.*

operate the business from the same location, and the franchisee that has effectively been placed out of business by the nonrenewal.<sup>488</sup>

*x. Franchise Termination*

FIPA's Bill of Rights contains a provision limiting a franchisor's ability to terminate a franchise agreement.<sup>489</sup> Under this provision, "termination" means to terminate the franchisee's contractual license to use the franchisor's trademark, trade name, logo, or the like during the term of the parties' agreement.<sup>490</sup> Thus, in *Coast to Coast Stores, Inc. v. Gruschus*, the Washington Supreme Court held that a franchisor did not terminate a franchise when it refused to supply additional inventory and enforced its rights as a secured party by reaching an agreement with the franchisee to lock the doors of the franchisee's store, causing the cessation of the franchise business.<sup>491</sup> Instead, the Court noted that the "franchise" is distinct from the business operated under the franchise, and while the franchisee's business may have come to an end, the franchise (the contractual right to use the franchisor's marks) was not terminated.<sup>492</sup> The Court's reasoning in *Coast to Coast Stores* (later confirmed by the state supreme court in *Corp v. Atlantic Richfield Co.*<sup>493</sup>) belies any claim for constructive termination—that the franchisor has acted in such a manner as to make it difficult or impossible for the franchisee to continue operations—at least where the franchisor's actions are not designed to drive a particular franchisee out of business. One court has gone so far as to say that any claim for constructive termination is not actionable under FIPA.<sup>494</sup>

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488. The lion's share of a franchisee's good will is related to its continuing operations with the same employees dealing with the same customers at the same location. It would make little sense, therefore, to compensate a non-renewed franchisee that continues to operate the same business at the same location under a different flag in the same fashion as the franchisee whose nonrenewal forced it out of the business because of the franchisor's control of the real estate. It may be that the lost good will of the reflagged franchisee is minimal while the dispossessed franchisee's loss of good will may be substantial. Of course, the value of the good will lost by the dispossessed franchisee will not always be substantial. Non-renewed franchisees are often franchisees that have substantially underperformed, and it is hard to see how the value of a non-renewed franchisee's good will could be substantial if it was consistently losing money before nonrenewal.

489. WASH. REV. CODE § 19.100.180(2)(j) (2008).

490. *Coast to Coast Stores, Inc. v. Gruschus*, 100 Wash. 2d 147, 153, 667 P.2d 619 (1983).

491. *Id.*

492. *Id.* at 154.

493. 122 Wash. 2d 574, 585, 860 P.2d 1015 (1993); *see also* *Thompson v. Atlantic Richfield Co.*, Bus. Franchise Guide (CCH) ¶ 9,080 (W.D. Wash. June 17, 1987) (holding that franchisee's dislike for the terms of the new franchise agreement, even if strong enough to prompt franchisees not to seek renewal, simply is not the same as a refusal to renew or termination by the franchisor).

494. *Carlock v. Pillsbury Co.*, 719 F. Supp. 791, 852 (D. Minn. 1989), *superseded on other grounds by* 1989 Minn. Sess. Law Serv. 198 (West) (to be codified at MINN. STAT. § 80C.21).

FIPA provides that a franchise may be terminated “prior to the expiration of its term,” but only for “good cause.”<sup>495</sup> FIPA itself does not generally define good cause, and it is not entirely clear whether good cause includes legitimate business reasons by the franchisor—such as a market withdrawal or when the franchisor must terminate some of its franchisees to avoid insolvency—or whether good cause is limited to conduct by or involving a franchisee. No court has considered this issue under FIPA, and the legislative history sheds no light on the issue. Under other state franchise statutes, most courts have construed good cause as limited to franchisee bad behavior or conduct.<sup>496</sup>

While FIPA does not define good cause or describe all conduct that may constitute good cause, FIPA does provide that good cause includes, “without limitation,” a franchisee’s breach of a lawful material provision of the franchise or other agreement and the franchisee’s failure to cure such default after being given written notice and a reasonable opportunity to cure.<sup>497</sup> The franchisee is not entitled to notice and opportunity to cure lawful material breaches of the franchise agreement where the franchisee has committed three “willful and material breaches of the same term of the franchise agreement” within a twelve-month period, for which the franchisee has been given notice and an opportunity to cure.<sup>498</sup>

FIPA identifies four other instances in which a franchisor may terminate without first providing notice and an opportunity to cure, including when (1) the franchisee is adjudicated bankrupt or insolvent;

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495. WASH. REV. CODE § 19.100.180(2)(j) (2008).

496. *See, e.g.,* Solman Distrib., Inc. v. Brown-Forman Corp., 888 F.2d 170, 172 (1st Cir. 1989) (business reasons of the franchisor were not good cause under the Maine franchise statute); Remus v. Amoco Oil Co., 794 F.2d 1238, 1241 (7th Cir. 1986) (holding that good cause is limited to faults of the franchisee); Kealey Pharmacy & Home Care Servs., Inc. v. Walgreen Co., 761 F.2d 345, 350 (7th Cir. 1985) (holding that Walgreen’s termination of all its Wisconsin franchises and replacement with Walgreen-owned stores was not supported by good cause; although Walgreen had valid business reasons to make this change, nevertheless, because Walgreen intended to appropriate the good will established by the franchisees, Walgreen’s behavior was opportunistic and, therefore, economic justifications alone were not sufficient); Carlos v. Philips Bus. Sys., Inc., 556 F. Supp. 769, 776 (E.D.N.Y. 1983) (restructuring designed to “address the market place as it exists today” is not good cause under the New Jersey franchise act). *But see* Am. Mart Corp. v. Joseph E. Seagram & Sons, Inc., 824 F.2d 733, 734 (9th Cir. 1987) (Seagram’s adoption of a new, nationwide marketing plan justified its termination of its Nevada franchises on the basis that the terminations were warranted by compelling business considerations and constituted a valid business judgment.).

497. WASH. REV. CODE § 19.100.180(2)(j) (2008). The provision adds that the cure period need not be more than thirty days except where the default cannot reasonably be cured within thirty days, in which case the franchisee must initiate substantial and continuing action to cure its default within a thirty-day period. *Id.* The provision suggests that the cure period may be less than thirty days, but does not address when a lesser cure period would be appropriate. *Id.* A cure period less than thirty days may be “reasonable” if the default can be cured within this period or the nature of the violation is such that is reasonable for a franchisor to provide a lesser period. *See id.*

498. *Id.*

(2) the franchisee makes an assignment for the benefit of creditors or similar disposition of assets; (3) the franchisee voluntarily abandons the franchised business; and (4) the franchisee is convicted of, or pleads guilty or no contest to, a charge of violating any law relating to the franchise business.<sup>499</sup>

These five exceptions are extremely narrow. They do not cover all situations in which a franchisor would reasonably want to quickly terminate a franchise, such as where a franchisee is caught defrauding or stealing from the franchisor or where the franchisee is conducting illegal activities from the franchised premises. Such conduct would likely constitute good cause for termination.<sup>500</sup> Thanks to the sloppy drafting of FIPA, what is not particularly clear is whether such misbehavior is grounds for termination without notice and opportunity to cure. This issue was addressed in two cases decided just weeks from each other by the same United States District Judge.

In the first case, *Beulich v. ARCO Products Co.*,<sup>501</sup> the franchisee entered into two separate franchise agreements with ARCO: (1) an ARCO petroleum franchise subject to the federal Petroleum Marketing Practices Act<sup>502</sup> (PMPA); and (2) a convenience store franchise that the franchisee operated on the premises leased under the petroleum franchise. Under the convenience store franchise, ARCO regularly offered special promotions on one or more key convenience store products and would pay a rebate, or promotional allowance, for each unit of the promoted product the franchisee reported as sold.<sup>503</sup> The franchisee falsely reported sales of the promoted products by changing the product's price

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499. *Id.*

500. See *Ormsby Motors, Inc. v. Gen. Motors Corp.*, 842 F. Supp. 344, 350–51 (N.D. Ill. 1994) (finding good cause for termination under the Illinois Motor Vehicle Franchise Act where fraudulent warranty claim activity “occurred repeatedly and over a substantial period of time” and “was more than an isolated incident”); *Craig Foster Ford, Inc. v. Iowa Dep’t of Transp.*, 562 N.W.2d 618, 622–23 (Iowa 1997) (affirming administrative and lower court findings that there was good cause to terminate a franchisee under Iowa franchise law where franchisee made false reports under a marketing cash rebate program); *GTE Prods. Corp. v. Broadway Elec. Supply Co.*, 676 N.E.2d 1151, 1157 (Mass. App. Ct. 1997) (holding electrical supplies distributor’s submission of fraudulent end user discounts constituted just cause for termination where distributorship contract could only be terminated for cause: “[c]ulpable behavior is ‘just cause’ cause for termination”); *Chesapeake Ford, Inc. v. Ohio Motor Vehicle Dealers Bd.*, 660 N.E.2d 481, 484–85 (Ohio Ct. App. 1995) (pervasive fraud in an automobile service department, including billing for work not performed, constitutes good cause to terminate the franchise under Ohio franchise law); see also Charles J. Faruki, *The Defense of Terminated Dealer Litigation: A Survey of Legal and Strategic Considerations*, 46 OHIO ST. L.J. 925, 984–85 (1985) (discussing cases in which dishonest practices by dealers satisfy good cause requirements for termination of exclusive dealer arrangements).

501. Bus. Franchise Guide (CCH) ¶ 11,657 (W.D. Wash. Mar. 13, 1998), *aff’d*, 182 F.3d 924 (9th Cir. 1999).

502. 15 U.S.C. § 2801 (2006).

503. *Beulich*, Bus. Franchise Guide (CCH) ¶ 11,657.

in his electronic cash register, or Point of Sale system, to one cent.<sup>504</sup> The franchisee then recorded or scanned a number of phantom one cent sales before changing the price in the POS system to the regular retail price, collecting promotional rebates from the franchisor for each phantom sale.<sup>505</sup> Until caught by ARCO, the franchisee recorded 5,892 phantom sales of promotional items.<sup>506</sup> After discovering the irregularities, ARCO asked the franchisee for an explanation.<sup>507</sup> Without explaining what had happened, the franchisee acknowledged that the accounting errors found by ARCO were probably correct, although he later asserted his Fifth Amendment privilege against self-incrimination.<sup>508</sup> He attempted to tender to ARCO the amount he had obtained based on phantom sales, but ARCO nonetheless terminated both franchises based on his fraudulent conduct.<sup>509</sup>

The franchisee filed suit seeking to enjoin the termination, claiming that the termination was improper under both the PMPA and under FIPA.<sup>510</sup> The district court did not decide the FIPA issues. It instead

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504. *Id.*

505. *Id.*

506. *Id.*

507. *Id.*

508. *Id.*

509. *Id.*

510. *Id.* Although ultimately the Court of Appeals found that FIPA was preempted, the franchisee had argued, with respect to his claim under FIPA, that unless the grounds for termination fit within one of the narrow exceptions provided by the statute, the franchisor cannot terminate a franchise without giving the franchisee notice and an opportunity to cure. The franchisee also argued that he had in fact “cured” his default by tendering to ARCO the amount he had wrongly obtained by misusing the display allowance program. *Id.* ARCO rejected both of these contentions, arguing first that the franchisee had not “cured” its defaults by simply offering restitution of the amounts stolen. *Id.* While paying ARCO the amounts owed may satisfy his contractual obligation to pay, it did not cure the fraud. *Id.* Otherwise stated, the termination was not based on the failure to pay money, it was based on the pattern of fraudulent conduct which had undermined the shared trust upon which the franchise relationship was based. See *Humboldt Oil Co. v. Exxon Co., U.S.A.*, 695 F.2d 386, 389 (9th Cir. 1982) (Termination based on a franchisee’s fraudulent conduct is justified because the “[g]ood faith belief of the franchisor that the franchisee is untrustworthy or engages in fraudulent practices undermines the entire franchise relationship.”); see also *Jiffy Lube Int’l, Inc. v. Weiss Bros., Inc.*, 834 F. Supp. 683, 688 (D.N.J. 1993) (finding that a franchise was properly terminated based on the franchisee’s reporting of false information to the franchisor, and stating that “[w]hile the amount of royalties may not be significant in dollar amount, the integrity of information flowing from franchisor to franchisee goes to the very heart of the relationship”); *Dunkin’ Donuts, Inc. v. Chetminal, Inc.*, Bus. Franchise Guide (CCH) ¶ 11,290 (S.D. Fla. Oct. 30, 1997) (relying on the Ninth Circuit’s decision in *Humboldt Oil*, and stating that a franchisee’s conduct was “willful criminal conduct that could not be cured”). Such trust could not be cured simply by paying what money was due, and indeed, to allow the franchisee to “cure” the default simply by paying what was due would only encourage cheating by franchisees because they would know that if caught all they would be required to do was repay what they should have paid in the first instance. *Beutlich*, Bus. Franchise Guide (CCH) ¶ 11,657. Second, ARCO argued that FIPA’s enumerated exceptions were not exclusive, but merely illustrative of the kinds of wrongs justifying termination without notice and an opportunity to cure. *Id.* On its face, the statute provides only that notice and opportunity to

upheld the termination on summary judgment, holding that the termination of the franchises was proper under the PMPA, which preempted state law.<sup>511</sup>

The court decided the second case, *Malek v. Southland Corp.*, just weeks after *Beutlich*; but here, the outcome was not so fortunate for the franchisor.<sup>512</sup> In *Malek*, a franchisee had misappropriated money orders.<sup>513</sup> After discovering the franchisee's improprieties, the franchisor terminated the franchise without providing the franchisee an opportunity to cure, grounding its termination on a breach of the franchise agreement's requirement that the franchisee maintain accurate bookkeeping records and financial records.<sup>514</sup> Though the franchisee did not deny the misappropriation of money orders, the franchisee sought to enjoin the termination.<sup>515</sup>

Southland argued that the franchisee had acted in bad faith and that only "innocent" franchisees could claim protection under FIPA.<sup>516</sup> Southland also protested that it would be "preposterous" that a "franchisee may routinely and intentionally defraud his franchisor with impunity, provided that he takes care not to get caught four times in any twelve month period."<sup>517</sup> Preposterous or not, the district court, indicating that is exactly what FIPA provides, granted the franchisee's motion for summary judgment and held that Southland had violated FIPA by not affording the franchisee an opportunity to cure its defaults.<sup>518</sup> The

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cure need not be provided in the enumerated situations where termination is based on a breach of the franchise agreement—the statute does not provide, at least expressly provide, that these enumerated exceptions apply where termination is based on other grounds constituting "good cause." *Id.* Indeed, it is at least arguable that these enumerated exceptions are merely illustrative (and not exclusive) or that only in the enumerated situations can the franchisor dispense with notice or allowing the franchisee to cure.

511. *Beutlich*, Bus. Franchise Guide (CCH) ¶ 11,657.

512. Bus. Franchise Guide (CCH) ¶ 11,386 (W.D. Wash. Apr. 10, 1998).

513. *Id.*

514. *Id.*

515. *Id.*

516. *Id.* Southland advanced neither of the arguments made by ARCO in *Beutlich*. See discussion *supra* note 510.

517. *Malek*, Bus Franchise Guide (CCH) ¶ 11,386. Southland was referencing the provision of FIPA that permits a franchisor to terminate without notice and opportunity to cure after the franchisee has willfully committed three material breaches of the franchise agreement in the preceding twelve months. See WASH. REV. CODE § 19.100.180(2)(j) (2008). This provision was added to FIPA in 1980, as an additional means of termination available to franchisors. An Act Relating to Franchise Investment Protection, ch. 63, § 1, 1980 Wash. Sess. Laws 147, 149. Prior to the amendment, a franchisee's willful breach of the franchise agreement was grounds for termination only with notice and opportunity to cure. The implication of that prior construction was that a franchisor could never terminate a franchisee that cured its breach, regardless of how many times the franchisee committed the breach. The inequity was remedied by the 1980 amendment.

518. *Malek*, Bus Franchise Guide (CCH) ¶ 11,386. Given that the same court denied a similar claim in *Beutlich* just weeks prior to the decision in *Malek*, the only explanation for the discrepancy

court's rejection of Southland's arguments suggests it interpreted FIPA to require that a franchisor afford a franchisee a reasonable opportunity to cure its defaults before the franchisor can terminate a franchise, unless the franchisee's conduct fits squarely within one of the express exceptions set-forth in FIPA.<sup>519</sup>

### 3. Other Relationship Issues Not Covered Under the Bill of Rights

#### *i. Franchise Transfers*

FIPA's Bill of Rights does not address a franchisee's rights to assign or transfer its franchise rights. This was not always the case. An initial draft of FIPA would have barred franchisors from insisting upon any "unnecessary restrictions on the franchisee having to do with *transfer*, sale, [or] right to renew . . . ."<sup>520</sup> This language was rejected in later drafts in favor of language making it unlawful "to terminate a franchise or to *restrict the transfer of a franchise* unless the franchisee receives fair and reasonable compensation for the value of the franchise."<sup>521</sup> This proposal, too, was subsequently rejected.

While the legislature decided not to regulate franchise transfers, the Washington Securities Division has attempted to regulate a franchisor's imposition of transfer fees because of their supposed effect on franchise transfers. The Securities Division's Interpretive Statement states that transfer fees charged by a franchisor are impermissible to the extent they exceed the franchisor's "expenses directly incurred as a result of trans-

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between the *Beulich* and *Malek* decisions is the absence of the PMPA claim in the *Malek* case. It appears that the court was convinced that fraud is sufficient grounds for termination without notice under the PMPA, but not under FIPA.

519. The court's holding is inconsistent with the legislative history of FIPA. The type of willful contract breach contemplated by the legislature in the 1980 amendment was a breach arising directly out of the terms of the franchise agreement. For example, one of the bill's primary proponents argued that a franchisee's failure to maintain inventory at the level provided in the franchise agreement would constitute a willful breach of the agreement that would subject the franchisee to possible termination without notice and opportunity to cure if it occurred more than three times in a twelve-month period. *See Coast to Coast Stores, Inc. v. Gruschus*, 100 Wash. 2d 147, 158, 667 P.2d 619 (1983) (citing SENATE JOURNAL, 46th Legislature, at 500 (Wash. 1980) (statement of Sen. Rasmussen)). Failure to comply with inventory requirements in the franchise agreement is a far cry from theft or fraud. A better reading of the statute is that notice is generally required for material breaches of the franchise agreement, but not for other types of good cause, including the five enumerated exceptions but also including circumstances such as theft or fraud. This is consistent with the statute's statement that the enumerated instances of good cause that are specifically identified are "without limitation," and that there is no logical reason to exclude intentional and material deception, misconduct, or illegal actions from the non-exclusive "good cause" definition. *See WASH. REV. CODE* § 19.100.180(2)(j).

520. Fletcher, *supra* note 22, at 118 (emphasis added).

521. *Id.* at 195 (emphasis added).

fer,” because those excess fees may impede transfer.<sup>522</sup> The agency’s pronouncement does not have the force of law and represents only, as one court bluntly described another Securities Division Interpretive Statement, the “advisory opinion of a state bureaucrat.”<sup>523</sup> In this context, the legislature’s decision not to regulate or restrict transfer rights is particularly telling. Still, this does not mean the agency’s pronouncement has no consequences. As the agency responsible for overseeing franchise registration in Washington, the Securities Division’s practice has *often* been to “enforce” its Interpretive Statement by refusing to accept a franchisor’s registration application if the franchise agreement form contains a transfer fee the Division considers excessive.

Good reasons support a franchisor’s use of transfer fees. Such fees are only a component of the overall price of a franchise, and the use of a transfer fee may allow a franchisor to hold down the amounts it would otherwise charge for an initial fee or for royalties. From a franchisee’s perspective, a transfer fee thus allows it to defer payments it would otherwise make during the term until the franchise is sold, when payment can be made from the proceeds of sale rather than from operating revenues. Moreover, franchise transfers are often costly for the franchisor. In addition to out-of-pocket costs, a franchisor may incur significant opportunity costs that may be difficult to quantify. New franchisees must be vetted for qualifications, and they generally require more resources than established franchisees. Also, it often takes time for a new franchisee—even when taking over an established business—to duplicate the royalty streams that had been produced by the transferring franchisee. Transfer fees therefore allow a franchisor to recoup at least some of these costs. Finally, the FDD format requires the franchisor to disclose any contractually required transfer fees prior to sale, so the franchisee knows exactly what he will be required to do before buying the

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522. See FIS-2, *supra* note 275. This Interpretive Statement was based not only on the assumption that transfer fees unreasonably restrict transfer, and that this is somehow inappropriate under FIPA, but upon the duty of good faith contained in section 19.100.180(1) of the Revised Code of Washington and the Bill of Rights’ prohibition against the imposition of an unreasonable and unnecessary “standard of conduct.” See also Chisum, *supra* note 1, at 370 (also citing FIPA’s good faith requirement as a basis to “require a showing of reasonable grounds as a prerequisite to refusal” to approve a transfer). It is difficult to imagine how the duty of good faith, which does not itself impose any substantive requirements, can be read as support for the Securities Division’s attempt to restrict negotiated contract provisions. It is also difficult to see how the charge of a transfer fee, which may be thought of simply as a deferred franchise fee, can be viewed as a “standard of conduct.” Moreover, if mere “reasonableness” can be the basis to strike or require amendment of any provision of a franchise agreement, then there would be no meaningful limits to the authority delegated to the Division.

523. *Mgmt. Recruiters Int’l, Inc. v. Bloor*, 129 F.3d 851, 855–56 (6th Cir. 1997).

franchise.<sup>524</sup> Thus, there is neither any legal basis nor any practical need to restrict contractually agreed-upon transfer fees.

### ii. Covenants Against Competition

Covenants against competition (both in-term and post-term) are common in franchise agreements.<sup>525</sup> FIPA itself, however, contains no provisions that directly address the legitimacy of covenants against competition. Such contractual provisions are arguably subject to FIPA's requirement that all "standards of conduct" must be reasonable and necessary. However, no court has expressly considered that issue. The courts to consider restrictive covenants in franchise agreements have held that franchise agreements are akin to employment agreements and, as such, are subject to the same standards applicable to the enforcement of a noncompete in an employment agreement.<sup>526</sup>

Under Washington law, restrictive covenants in employment agreements are enforceable only to the extent that they are "reasonably necessary to protect the business or good will of the employer."<sup>527</sup> Washington courts have not made any distinction between in-term covenants and post-term covenants when evaluating the legitimacy of a particular covenant. If a covenant is unreasonable as written, the court will modify and enforce it only to the extent that it is reasonable.<sup>528</sup>

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524. 16 C.F.R. § 436.5(f).

525. See Robert W. Emerson, *Franchising Covenants Against Competition*, 80 IOWA L. REV. 1049, 1050-51 n.5 (1995).

A study over twenty years ago showed that about two-thirds of all franchise agreements contained a noncompetition covenant. 52% of the contracts placed a distance restriction on the covenantor, while 60% had a time limitation. Updating that study, from October 1992 to February 1993 the author of this Article obtained copies of 100 current franchise agreements (the standard forms used by the franchisors) in order to verify the frequency and general content of various provisions. 98% of those agreements contained covenants against post-termination competition. Likewise, the percentage with specific distance and time provisions increased dramatically above the figures from the 1971 study, from below 60% in 1971 to 98% in 1993.

*Id.* (citing Robert W. Emerson, *Franchise Contract Clauses and the Franchisor's Duty of Care Toward Its Franchisees*, 72 N.C. L. REV. 905, 969 (1994)).

526. See *Armstrong v. Taco Time Int'l, Inc.*, 30 Wash. App. 538, 543, 635 P.2d 1114 (1981).

527. *Wood v. May*, 73 Wash. 2d 307, 309, 438 P.2d 587 (1968).

528. See, e.g., *BDK, Inc. v. Escape Enters., Inc.*, 106 F. App'x 535, 538-39 (9th Cir. 2004) (holding that a noncompetition clause barring former franchisee from operating a restaurant that sells food products similar to that offered by franchisor within a three-mile radius of any of franchisor's outlets was reasonable); *Harb v. Norrell Servs., Inc.*, Bus. Franchise Guide (CCH) ¶ 10,231 (W.D. Wash. Mar. 25, 1993) (holding that franchisor had a valid interest in enforcing covenants not to compete and affirming noncompetition covenants barring a franchisee from operating within the exclusive territory designated in the franchise agreement for a period of one year following termination as reasonable in both duration and geographic area); *Chico's Pizza Franchises, Inc. v. Sisemore*, Bus. Franchise Guide (CCH) ¶ 8,041 (E.D. Wash. Aug. 29, 1983) (holding that as modified, a non-competition agreement that prohibited pizza franchisees from selling pizzas in any market area in

## VI. CONCLUSION

Although FIPA is approaching its fourth decade, a host of issues remain unresolved and unexamined. While a number of provisions appear on their face to be potentially problematic (particularly in the Franchisee Bill of Rights section of the Act), the lack of discourse over the decades suggests that courts have not been overly concerned about FIPA's internal inconsistencies. It is probably also a sign that the prevalence of franchisor abuse was overstated by FIPA's original advocates. In any event, Washington's regulation of franchising has evolved substantially since it was originally implemented in the early 1970s and has largely reflected the evolution of franchising itself in this country.

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which the franchisor did business during the term of the franchise, and for three years afterward, was reasonable); *Armstrong*, 30 Wash. App. at 544 (as rewritten by the court, a noncompetition covenant that barred the franchisee from operating within the franchise agreement's territory or in any other franchisee's territory during the term of the agreement and for a period of 2.5 years after termination, was reasonable and served the franchisor's legitimate interest in protecting its ability to sell franchises and its interest in protecting other franchisees from competition).